



U.S. Department of Agriculture



Office of Inspector General  
Southwest Region

# Audit Report

## Rural Utilities Service Broadband Grant and Loan Programs

Audit Report 09601-4-Te  
SEPTEMBER 2005

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



September 30, 2005

TO: Curtis M. Anderson  
Acting Administrator  
Rural Utilities Service

THROUGH: John M. Purcell  
Director  
Financial Management Division

FROM: Robert W. Young /s/  
Assistant Inspector General  
for Audit

SUBJECT: Audit Report 09601-4-Te - Broadband Grant and Loan Programs

This report presents the results of the subject audit. Your written response to the draft report, dated September 30, 2005, is included as exhibit E with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant Findings and Recommendations sections of the report.

Based on the response, management decisions were reached on Recommendations 6, 7, and 12. Please follow Departmental and your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer, Director, Planning and Accountability Division (OCFO/PAD).

Although we agree with most of the other planned corrective actions, management decisions could not be reached on Recommendations 1, 2, 3, 4, 5, 8, 9, 10, 11, 13, and 14. Documentation and actions needed to reach management decisions for these recommendations are described in the OIG Position sections of the report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementing those recommendations for which management decision has not been reached. Please note that the regulation requires a management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Performance and Accountability Report.

We appreciate your timely response and the courtesies and cooperation extended to us by members of your staff during the audit.

# Executive Summary

## Rural Utilities Service Broadband Grant and Loan Programs (Audit Report 09601-4-Te)

### Results in Brief

During the 4 years the Rural Utilities Service (RUS) has administered Federal loans and grants for extending broadband service to rural America, the programs' focus has shifted away from those rural communities that would not, without Government assistance, have access to broadband technologies. This change in the programs' emphasis has occurred for two reasons. First, in its loan program, RUS has not satisfactorily implemented statutory requirements for serving rural instead of suburban areas, nor does it have a system that can guarantee that communities without preexisting service receive priority. Second, RUS' inconsistent administration of the programs has resulted in irregularities in approving and servicing grants and loans. Of the \$895 million in loans and grants funded, we reviewed \$599.1 million (67 percent) and questioned the use of over \$340.4 million—almost 57 percent of the approved funds reviewed. (See table 1 below.)

DESCRIPTION	AMOUNT IN MILLIONS (Rounded)	
<b>Finding 1</b> - Loan Funds Awarded to Suburban Communities on the Outskirts of Large Cities <sup>1</sup>		\$103.4
<b>Finding 3</b> -		
Loan Funds Approved Even Though Applications Were Incomplete <sup>2</sup>	\$137.4	
Grant Funds Used for Unauthorized Purposes	1.9	
Grant Funds Not Yet Advanced but at Risk	.8	
Defaulted Loans	30.4	
Loan and Grant Funds Not Drawn Down	59.3	
Loan Funds Canceled but Not Reobligated	6.8	
Total for Finding 3		236.6
<b>Finding 4</b> - Duplicate Funding for Same Community		.4
<b>TOTAL</b>		<b>\$340.4</b>

Table 1

In order to assess RUS' management controls (Fiscal Years 2001 through 2005, as of March 10, 2005) over the Broadband Grant and Loan Programs and to determine the appropriateness of grant and loan usage, the Office of Inspector General (OIG) reviewed 33 of 90 funded grants totaling \$20.2 million of \$41 million, or 49 percent of the total funded amount. We also reviewed 28 of 64 funded loans totaling \$578.9 million of \$854 million, or 68 percent of the total funded amount.

<sup>1</sup> \$106,155,452 was loaned for this purpose; however, \$2,743,554 of this amount is duplicated in the loans in default discussed in Finding 3.

<sup>2</sup> \$179,536,000 in loans was approved without complete applications; however, \$42,101,750 of this amount is duplicated in those loans made to communities on the periphery of large urban areas.

Based on this review, we found that RUS has not maintained its focus on rural communities without preexisting service. Although the language of the law specifies that these Federal loans and grants are for rural communities, RUS has codified and implemented a definition that cannot reliably distinguish between rural and suburban areas. Due to this ambiguous definition, the agency has issued over \$103.4 million<sup>3</sup> in loans to 64 communities near large cities, including \$45.6 million in loans to 19 planned subdivisions near Houston, Texas.

Although RUS has interpreted the law<sup>4</sup> as permitting loans to competing rural broadband providers, regulations permit it to do so only after prioritizing and serving those communities without existing service. The agency's current system for prioritizing underserved communities cannot, however, guarantee that communities without broadband access will be preferred to those already with access. Furthermore, we question whether the Government should be providing loans to competing rural providers when many small communities might be hard pressed to support even a single company. In these circumstances, RUS may be setting its own loans up to fail by encouraging competitive service; it may also be creating an uneven playing field for preexisting providers operating without Government assistance.

The loan program's lack of focus on rural communities without preexisting service has been paralleled by RUS' continuing need to create a management structure able to make necessary judgments for a program of this size and scope. Since the loan and grant programs' inception, RUS personnel have functioned without written standard operating procedures specific to the broadband programs for approving and servicing loans and grants; without standard written procedures, personnel did not always process and service grants and loans consistently and correctly. Due to these irregularities, \$236.6 million in loans and grants intended to bring broadband service to rural communities was either not used as intended, not used at all, or did not provide the expected return in service.

Though the Broadband Grant and Loan Programs serve similar needs, RUS has kept the programs separate, resulting in one group not always knowing what the other is doing. In such a situation, loans and grants may be unintentionally issued to the same communities, creating competition where none is wanted. In one case, for instance, a grant for \$383,284 was approved for a community that had already received a broadband loan, even though grant instructions forbid such duplication.<sup>5</sup> Coordinating these two separate programs has been a challenge for RUS, especially since its database does not contain all relevant broadband grant and loan information and does not facilitate communication between the programs. Without a complete and

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<sup>3</sup> See footnote 1.

<sup>4</sup> Public Law 107-171, dated May 13, 2002.

<sup>5</sup> *Federal Register*, Vol. 67, No. 130, "Notice of Funds Availability," dated July 8, 2002.

accurate information system, management cannot make program decisions based on the best information available.

We conclude that RUS needs to return these programs' focus to the rural communities most in need of Government assistance, and to correct structural problems in its administration of the Broadband Grant and Loan Programs. Until these changes are made, RUS cannot be confident that Federal funds are being used to bring broadband service to those rural communities most in need of assistance.

## **Recommendations In Brief**

We recommend that RUS seek an Office of the General Counsel (OGC) opinion to clarify its definition of eligible rural area to more effectively implement the statutory requirements.

RUS should create a unified management structure capable of effectively administering the broadband programs. That management structure should include an informational management system sufficient to the programs' needs, as well as specific written procedures for approving and servicing loans and grants.

RUS should recover \$30.4 million in defaulted loans, and \$1.9 million in grants issued to a company that deviated from its grant agreement. In addition, the agency should deobligate \$762,226 in grant funds approved to the same company.

## **Agency Response**

RUS stated that its interpretation of the statutes resulted in definitions of "rural area" acceptable to OGC, and that it was clearly Congress's position that this definition be as broad as possible to cover as many rural citizens as possible. Further, even if OGC were to opine that the agency could restrict the definition narrower than Congress intended, it would still be a matter of policy as to what restrictions, if any, should be imposed.

RUS is unifying some parts of its management structure for grants and loans, upgrading its information management system, and developing written guidance for the programs to be implemented by March 30, 2006.

RUS transferred the six defaulted loans totaling \$30.4 million to its division responsible for working with borrowers in default and recovering outstanding loan balances. The division is currently working with the borrowers. Also, RUS is in the process of recovering the \$1.9 million in grant funds that was not accounted for properly, and has suspended advances of remaining funds to company B while the situation is being reviewed.

## OIG Position

We fully understand that the responsibility of determining how broadly or narrowly “rural” should be defined lies with RUS management. Our recommendation neither states nor implies that RUS should make the definition “narrower than Congress intended”; instead, OIG maintains that Congress’s current language was meant to serve only as a broad definition for bringing broadband service to rural citizens, and that the clear purpose behind the program was to fund service to the truly rural. We do not believe Congress foresaw that this broad definition might be used to justify funding loans to affluent suburban communities while other more rural communities remained underserved. By focusing this definition—if OGC concludes that it may do so—RUS will bring the broadband programs in line with the Congressional purpose of serving rural areas that would not, without Government assistance, have access to broadband.

To achieve management decision, RUS needs to obtain a written opinion from OGC concerning whether RUS can revise its definition of an eligible rural area to more fully correspond to the law’s purpose. If OGC agreed with RUS in prior correspondence that the current definition of rural is the best possible, RUS should also provide OIG with documentation supporting that decision.

We concur with the management decisions for developing and implementing written guidance for the Broadband Grant and Loan Programs. For the most part, we agree with the other planned corrective actions. However, to reach management decision on the other issues, we will need further documentation and timeframes for implementation. Further documentation and actions needed are described in the OIG Position sections of the report.

## ***Abbreviations Used in This Report***

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CFR	Code of Federal Regulations
DM	Departmental Manual
FY	Fiscal Year
GAO	Government Accountability Office
GFR	General Field Representative
OGC	Office of the General Counsel
OIG	Office of Inspector General
RUS	Rural Utilities Service
2002 Farm Bill	Farm Security and Rural Investment Act of 2002

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# ***Background and Objectives***

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## **Background**

The Broadband Grant and Loan Programs were created to help rural communities enjoy the same quality and range of telecommunications services available to urban and suburban communities. The Rural Utilities Service (RUS) administers the programs designed to provide these services.

### **Broadband Grant and Loan Programs**

#### **Broadband Pilot Loan Program**

Amendments to the Distance Learning and Telemedicine Program in fiscal year (FY) 2001 authorized a Broadband Pilot Loan Program to provide funding for construction and operation of systems and facilities providing broadband services to rural areas.<sup>6</sup> Treasury rate loan funds totaling \$100 million were made available, through a 1-year pilot program, to encourage telecommunications carriers to provide broadband service to rural consumers where such service had not existed.<sup>7</sup> The Broadband Pilot Loan Program was extended in FY 2002 with \$80 million in loan funds.<sup>8</sup> As of March 2005, RUS had advanced funds for 24 of 28 approved loans totaling approximately \$119.4 million.<sup>9</sup> For the other \$60.6 million, about \$6.8 million was cancelled and \$53.8 million had not been advanced (see table 2).

#### **2002 Farm Bill Broadband Loan Program**

In FY 2003, RUS established the Rural Broadband Access Loan and Loan Guarantee Program, as authorized by the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill).<sup>10</sup> Section 6103 of the 2002 Farm Bill states that the Secretary shall make available funding levels for 2002 through 2007, and the funds would remain available until expended. It further states that the funds would be used through loans and loan guarantees to provide funds for costs of construction, improvement, or acquisition of facilities and equipment for broadband service in eligible rural communities. It defines rural communities as those with fewer than 20,000 inhabitants, as determined by the Census Bureau, and not located in a Standard Metropolitan Statistical Area.<sup>11</sup> The 2002 Farm Bill also defines the types of loans available. Further, the bill states that the Secretary shall give priority to eligible rural

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<sup>6</sup> Public Law 106-387, 114 Stat. 1549A-22, dated October 28, 2000.

<sup>7</sup> *Federal Register*, Vol. 65, No. 234, "Notice of Funds Availability," dated December 5, 2000.

<sup>8</sup> *Federal Register*, Vol. 67, No. 15, "Notice of Funds Availability," dated January 23, 2002.

<sup>9</sup> Of these loans, one was canceled.

<sup>10</sup> Public Law 107-171, dated May 13, 2002.

<sup>11</sup> The requirement of not being in a Standard Metropolitan Statistical Area was removed by the Consolidated Appropriations Act of 2004. See Finding 1 for a fuller history of this definition.

communities in which broadband service is not available to residential customers.

### Broadband Pilot Grant Program

Amendments to the Distance Learning and Telemedicine Program in FY 2002 authorized RUS to establish a Rural Broadband Pilot Grant Program.<sup>12</sup> These grant funds were for broadband transmission service in extremely rural, lower-income communities for the purpose of stimulating economic development and enhancing education and health care opportunities.

In FY 2002, RUS allocated \$20.8 million to the program but received more than 300 applications requesting over \$185 million.<sup>13</sup> Only the 40 highest-scoring applications were awarded grant funds in FY 2002, fully using the \$20.8 million.<sup>14</sup> Because of the overwhelming response, RUS did not solicit additional applications, but used its FY 2003 appropriation (\$11.3 million) to fund an additional 34 eligible projects submitted in FY 2002. As of March 2005, 54 recipients drew advances of over \$12.8 million of grant funds, with over \$19.3 million unobligated.

### Community Connect Grant Program

On July 28, 2004, RUS announced its Broadband Grant Program<sup>15</sup> application window through September 13, 2004.<sup>16</sup> The purpose of the program is to provide financial assistance in the form of grants to eligible applicants that will provide, on a “community-oriented connectivity” basis, broadband transmission service that fosters economic growth and delivers enhanced educational, health care, and public safety services. RUS will give priority to rural areas it believes have the greatest need for broadband transmission services. The grantees that receive broadband grants must (1) serve a rural area where broadband transmission service does not currently exist, to be verified by RUS before awarding the grant; and (2) serve one community recognized in the latest U.S. Census. Communities that are not recognized in the U.S. Census located in the contiguous areas outside the recognized communities’ boundaries can be included in the applicant’s proposed service area, but must be supported by documentation acceptable to RUS.<sup>17</sup>

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<sup>12</sup> Referred to by RUS in its funding notice as “community-oriented connectivity.”

<sup>13</sup> *Federal Register*, Vol. 67, No. 130, dated July 8, 2002, plus funds authorized for the Dial-up Internet Program.

<sup>14</sup> The applications were scored based upon the rurality of the projects (up to 40 points), the economic need of the projects (up to 20 points, then later changed to 30 points), and the benefits derived from the proposed service (up to 30 points).

<sup>15</sup> Referred to in the final notice as the Community Connect Grant Program.

<sup>16</sup> *Federal Register*, Vol. 69, No.144, “Notice of Solicitation of Applications,” dated July 28, 2004.

<sup>17</sup> Title 7, Code of Federal Regulations (CFR), section 1739.11, dated July 28, 2004.

Additionally, Federal regulations state that the applicant must contribute a matching contribution, which is at least 15 percent of the grant amount requested.<sup>18</sup> Applicants were required to submit an Application for Federal Assistance form by the FY 2004 deadline. RUS is to award grants competitively using the scoring guidelines in Federal regulations, and rank all complete applications received within the established timeframes.<sup>19</sup>

RUS obligated \$8.9 million for 16 broadband grants in 2004. RUS has announced that \$8.9 million is available for broadband grants in 2005.

**Table 2: Funding and Advances for the Loan and Grant Programs**

PROGRAM	AUTHORIZED	FUNDED	ADVANCED AS OF 3/8/05	CANCELLED FUNDING AS OF 3/8/05	UNLIQUIDATED AS OF 3/8/05
FY 2001 – Pilot Loan	\$100,000,000	\$100,000,000	\$70,531,811	\$152,669***	\$29,315,520
FY 2002 – Pilot Loan	\$80,000,000	\$80,000,000	\$48,904,251	\$6,640,295***	\$24,455,454
FY 2003 – Loan	\$56,263,000*	\$56,263,000	\$26,420,124		\$29,842,876
FY 2004 – Loan	\$602,946,931*	\$602,946,931	\$23,050,335		\$579,896,596
FY 2005 – Loan	\$2,078,975,023*	\$14,957,000+	\$0		\$14,957,000
FY 2002 – Pilot Grant	\$20,000,000	\$20,832,278**	\$7,795,191		\$13,037,087
FY 2003 – Pilot Grant	\$10,000,000	\$11,307,136**	\$5,058,244		\$6,248,892
FY 2004 - Grant	\$9,000,000	\$8,864,532	\$0		\$8,864,532
FY 2005 - Grant	\$8,900,000++				
<b>TOTAL</b>	<b>\$2,966,084,954</b>	<b>\$895,170,877</b>	<b>\$181,759,956</b>	<b>\$6,792,964</b>	<b>\$706,617,957</b>

\* Authorized funding is a combination of mandatory and discretionary funding. Unobligated funds from one fiscal year may be carried forward for obligation in more than one year.

\*\* Amount represents the total authorized for the Broadband Pilot Grant Program plus funds authorized for the Dial-up Internet Program, which authorized a combined account.

\*\*\* \$152,669 was rescinded because borrower received a loan under a special 9/11 program, \$2,104,000 was cancelled because the entity decided not to provide the service, and \$4,536,295 was cancelled because the borrower decided in 2004 to use a Farm Bill loan.

+ FY 2005 is as of March 10, 2005.

++ RUS published a Notice of Solicitation of Application on March 30, 2005, with an application deadline of May 31, 2005.

## Outreach

RUS has conducted a number of outreach activities since 2003 designed to disseminate knowledge of the broadband programs. We did not perform reviews or tests to determine the effectiveness of this outreach. A summary of outreach performed for each program is presented below.

<sup>18</sup> 7 CFR 1739.14, dated July 28, 2004.

<sup>19</sup> 7 CFR 1739.17, dated July 28, 2004.

### Outreach for Broadband Loan Program

RUS conducted two symposiums in 2003, as well as nine workshops from June 22, 2004, to March 4, 2005. The symposiums were held in Dallas, Texas, in March 2003, and in Minneapolis, Minnesota, in April 2003.

Workshops were held in the following cities and States:

- Harrisonburg, Virginia
- Manchester, New Hampshire
- St. Louis, Missouri
- Chicago, Illinois
- Philadelphia, Pennsylvania
- Biloxi, Mississippi
- Portland, Oregon
- Helena, Montana
- Phoenix, Arizona

Attendees were mostly from these nine States; however, most of the other continental States were represented at the workshops.

RUS advertised the workshops on its webpage and through General Field Representatives (GFR) and Rural Development State Office personnel contacts, as well as through press releases in industry and broadband association newsletters.

### Outreach for Community Connect Grant Program

RUS offers information regarding its Community Connect Grant Program during scheduled conventions and on its website. RUS National Office officials attended three public telecommunications conventions: the Western Telecom Alliance conventions are held twice a year while the Eastern Rural Telecom Association convention is held annually. RUS officials attended the Western Telecom Alliance conventions in Las Vegas, Nevada, April 26-29, 2004, and in Dallas, Texas, September 13-15, 2004. The third convention was the Eastern Rural Telecom Association convention held in Atlantic City, New Jersey, August 18-20, 2004. During these conventions, RUS officials gave presentations that covered the Community Connect Grant Program and held individual meetings with attendees to discuss the program.

Additionally, RUS conducts an Engineering and Management Seminar every 2 years. Attendees include State representatives, as well as RUS borrowers, consultants, contractors, regulators, and others. RUS field staffs conduct smaller, informal workshops, as needed or requested, with interested groups in the communities they serve. The field staff also

performs outreach via the telephone and meetings. The number of GFR outreach activities varies; however, RUS officials estimate at least two activities per field staff per year, covering all the States. All of the outreach activities are advertised by RUS, the Rural Development State offices, and the GFRs.

**Objective**

The objective was to assess RUS' management controls over the Broadband Grant and Loan Programs in order to determine the regulatory compliance and appropriateness of grant and loan usage.

## Section 1. Program Focus

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RUS has not exclusively served those rural communities most requiring Federal assistance to obtain access to broadband technologies. Because RUS' definition of "rural area" is too broad to distinguish usefully between suburban and rural communities, the agency has issued over \$103.4 million in grants and loans (nearly 12 percent of \$895 million in total program funds) to communities near metropolitan areas. In addition, RUS' current selection process cannot guarantee that areas lacking service will receive priority over areas where a borrower is merely upgrading service or entering into competition with preexisting providers. Though the law does not explicitly forbid issuing loans to communities with preexisting service, we question whether the Broadband Loan Program should be providing funds for competition in many of the communities served, while other communities go entirely without service.

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### Finding 1

#### **RUS Should Develop a More Precise Definition of "Rural Area"**

Although RUS is charged with issuing loans for the development of broadband services in rural areas, the definition RUS uses to identify these areas is too broad to distinguish between rural communities and affluent suburbs near major metropolitan areas. In order not to exclude rural communities located in the same county as large cities, the law defines "rural area" broadly enough that bedroom communities on the outskirts of metropolitan areas can be considered eligible. When RUS implemented this law, it did not clarify the definition to distinguish between rural and suburban communities. Due to the initial definition's ambiguity and RUS' subsequent codification of that ambiguity to clarify the law's intent, 64 communities near large cities received loans and grants totaling \$103.4 million.<sup>20</sup> At the end of our fieldwork, two additional loan applications totaling \$26.4 million were pending for communities near Houston, Texas, and Los Angeles, California.

#### Variants in the Statutory Definition of "Rural Area"

Three different statutory definitions of "rural area" have been advanced over the history of the Broadband Loan Programs.

On October 28, 2000, Congress authorized funds for a pilot program to finance broadband transmission and local dial-up Internet service in areas meeting the definition of "rural area" used by the Distance Learning and

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<sup>20</sup> \$106,155,452 was loaned for this purpose; however, \$2,743,554 of this amount is duplicated in the loans in default discussed in Finding 3.

Telemedicine Program.<sup>21</sup> That definition distinguishes between exceptionally rural areas (fewer than 5,000 inhabitants), rural areas (between 5,000 and 10,000), and mid-rural areas (between 10,000 and 20,000).<sup>22</sup> RUS announced that it would consider as eligible communities of 20,000 or fewer inhabitants where services did not already exist.<sup>23</sup>

On May 13, 2002, the Farm Security and Rural Investment Act tightened this definition by restricting eligible communities to any incorporated or unincorporated place that has fewer than 20,000 inhabitants, based on the most recently available population data of the Bureau of the Census. Such communities were also restricted to those outside any standard metropolitan statistical area.<sup>24</sup> This narrower definition effectively prohibited broadband loans to suburban communities.

On January 23, 2004, however, the FY 2004 Appropriations Act broadened the definition again. In order to avoid excluding rural communities located in counties near larger cities, the metropolitan statistical requirement was dropped. An eligible community was henceforth defined as any incorporated or unincorporated place with fewer than 20,000 inhabitants, based on the most recent available population statistics of the Bureau of the Census.<sup>25</sup> In effect, this definition is identical to the October 28, 2000, definition with the exception that loans could now be issued to areas with preexisting service. (See Finding 2.)

#### RUS' Implementation of the Statute

On November 17, 2004, the Congressional Rural Caucus's Committee questioned the RUS Deputy Administrator relating to the agency's administration of broadband loans. The committee's questions illustrate the breakdown in communication that occurred between the writing of this law and its implementation and suggest widespread confusion about the law's scope. One legislator, for instance, suggested that the law allowed RUS to exclude communities based on their affluence; another believed it helped startup companies instead of established broadband providers; a third suggested that the programs ought not to be funding competitive services at all.

All these notions are not, in fact, included in the statute RUS must follow, as the Deputy Administrator indicated; however, in his responses, the Deputy Administrator resorted to the letter of the law to explain why loans were made to suburban communities. Yet, in all three definitions of "rural area" discussed above, the statute's language clearly states that these loans are for rural, not suburban communities; in no way can that language be used to

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<sup>21</sup> Public Law 106-387, dated October 28, 2000.

<sup>22</sup> 7 CFR 1703.126(b)(2)(A-C), dated January 1, 2001.

<sup>23</sup> *Federal Register*, Vol. 65, No. 234, dated December 5, 2000.

<sup>24</sup> Public Law 107-171, section 601, b. 2., dated May 13, 2002.

<sup>25</sup> Public Law 108-199, section 772, dated January 7, 2003.

justify loans to suburban development projects. Though Congress's definition of "rural" was broad, the agency did not, as part of its implementation of the law, codify a definition narrow enough to draw necessary distinctions and serve as a practical foundation for the programs. Instead, RUS codified a definition applying to any definable tract of land where fewer than 20,000 people live. Because this definition might conceivably be applied to an incomplete development project in a metropolitan area—where no one lives since the project is incomplete—it is inadequate to distinguish "rural" from "suburban."

This, nevertheless, was the definition RUS proceeded to use as the basis for the broadband programs, with serious negative consequences. In one of the more highly publicized cases, RUS issued loans to a company providing broadband access to affluent suburban communities a few miles outside of Houston, Texas.

#### Affluent Suburban Developments Receive Loans

Following the October 28, 2000, definition, RUS issued a pilot loan to company A of almost \$22.9 million to provide broadband service for 12 undeveloped subdivisions on the outskirts of Houston—the largest city in Texas and the fourth largest in the United States. None of the 12 subdivisions was located within the boundaries of any community having a population greater than 5,000 inhabitants. According to the definition, then, they were exceptionally rural areas.

Although the population of the subdivisions allowed them to be characterized as rural, in most significant ways they were not rural at all. All 12 of the subdivisions in question were within a 10-mile radius of Houston's city limits.<sup>26</sup> Also, four of the subdivisions abutting Houston were on the outskirts of three other cities with populations over 20,000.<sup>27</sup> Nine of the subdivisions were within the extraterritorial jurisdiction<sup>28</sup> of Houston. One subdivision was within the jurisdiction of Missouri City, Texas, which is also within the 5-mile radius of Houston.<sup>29</sup> That the subdivisions came under the legal authority of nearby cities indicates that their classification as rural communities was questionable. Because of their location and property value, a RUS official stated that these subdivisions would probably be incorporated into Houston in the near future.

The subdivisions' proximity to urban areas also made broadband services available to them through means other than the pilot loan program. Company A provides broadband services to three other upscale subdivisions in the Houston area without Government funds.<sup>30</sup> In fact, one of the

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<sup>26</sup> See exhibit B, pages 1 and 2, note 1.

<sup>27</sup> See exhibit B, pages 1 and 2, note 2.

<sup>28</sup> Extraterritorial jurisdiction is the legal ability of a government to exercise authority beyond its normal boundaries.

<sup>29</sup> See exhibit B, pages 1 and 2, note 3.

<sup>30</sup> See exhibit B, pages 1 and 2, note 4.

subdivision's developers decided not to wait for the company's Government loan to be approved and contracted with another telecommunications company to install broadband services.<sup>31</sup> These facts suggest that company A could provide services to these developments without Government assistance, and that the services were readily available to these communities even if they did not exist at the moment of the company's application.

We concluded that, in this case, the Government's loan was not being used to extend service to rural areas that would not otherwise receive access to broadband, but instead to subsidize a company that would have provided the same service without the loan. The fact that the planned communities receiving the service are, in this instance, quite affluent (see exhibit C) has provoked considerable negative public comment.

Approving this sort of loan also meant refusing other loans to communities RUS would ordinarily serve as part of its mission to extend utilities to rural areas. Such communities will remain less attractive to providers than affluent suburbs, especially if subsidies are created to increase artificially the value of already desirable markets. We reviewed 38 letters of rejection sent to companies RUS turned down due to lack of funds the year the initial loan was made for the Houston provider: 4 of these proposals were for small rural communities well outside urban areas. Even farmers living in close proximity to the planned developments near Houston were excluded. One agency official explained their exclusion by citing the "economy of scale" needed to justify extending the broadband network to include their residences. "We want to deploy broadband where there is no broadband," the official stated. "There must be economies of scale to make the loan financially feasible."<sup>32</sup> Yet the loan programs appear to have been created to help extend service to areas where the economy of scale would not ordinarily suffice to justify service.

After the Broadband Pilot Loan Program had ended, RUS approved an additional \$22.7 million loan under the 2002 Farm Bill Loan Program to company A for broadband services in seven additional subdivisions near Houston. Because this loan was issued under the January 23, 2004, definition of "rural," the restriction regarding metropolitan statistical areas was no longer in effect. All seven subdivisions were within Houston's metropolitan statistical area.

Our review and analysis<sup>33</sup> of all approved and pending applications from 2001-2005<sup>34</sup> identified other communities similar to the suburban Houston subdivisions discussed above. In its loan program, RUS issued 11 other loans totaling over \$60.1 million to 43 communities near 13 other large<sup>35</sup>

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<sup>31</sup> See exhibit B, pages 1 and 2, note 5.

<sup>32</sup> Barry Shlachter, "High-end Houston-area homes to get broadband courtesy of federal aid," *Fort Worth Star-Telegram*, October 13, 2004.

<sup>33</sup> See the Scope and Methodology for a complete description.

<sup>34</sup> As of March 10, 2005.

<sup>35</sup> We define "large" cities as those having a population of greater than 200,000.

cities in 10 different States; 2 loan applications totaling \$26.4 million for communities near Houston and Los Angeles were also pending. In the pilot grant program, we identified two grants issued in September 2003 totaling \$477,705 for two communities located near large cities. All of these 45 communities possessed 1 or more of the 3 criteria characterizing the Houston subdivisions—proximity to a major metropolitan area, relatively affluent inhabitants, and home values exceeding the national and State averages. None of the 2004 grants, however, were for communities near large cities.

#### Definition of “Rural Area” Needs Revision to Meet Program Objectives

As the loans issued to company A in Houston demonstrate, RUS has implemented several definitions sharing similar shortcomings. First, these definitions have relied only on population for defining what is rural and what is not. Second, they are vague about the geographical space over which that population may be distributed. Third, they do not address the Government’s role in subsidizing broadband access, that is to say, to help bring service to communities unattractive to private investment under ordinary market conditions. RUS should revise its definition of “rural area” to take into account the following observations.

##### Population

Population totals alone are not a viable way of determining if an area is urban or rural. In the report RUS issued jointly in 2000 with the National Telecommunications and Information Administration, it concluded that classifying as rural any community with a small population outside a major metropolitan area is inaccurate. Such definitions “may include areas that are only temporarily rural, such as suburban developments with brand new utilities built relatively close to an urban or suburban area. These areas tend to be relatively affluent, and their characteristics are more like the adjacent metropolitan area than what one ordinarily thinks of as rural. Rural statistics can be misleading if these variations are not considered.” Like the definition used for issuing broadband loans, the definition criticized above identifies rural communities strictly based on their population. Just as RUS concluded that designations made solely from population statistics are misleading, we conclude that classifying these Houston-area subdivisions as eligible for rural broadband loans was misleading.

A more nuanced statistical measurement might be used to identify eligible rural areas. After finding similar problems with identifying rural communities solely on the basis of population, a recent Government Accountability Office (GAO) audit suggested, as an alternative, using the Census Bureau’s urbanized areas and urban

clusters, which are density-based measures that provide finer-scale information.<sup>36</sup> Another alternative might involve correlating population density with distance from urban areas. Because most suburban developments are near cities, correlating these two characteristics might yield a reasonable determination of whether or not an area should be considered rural.

### Geographic Space

Past definitions have been vague about whether these loans are intended for preexisting communities or simply for areas or places. An undeveloped piece of land with no inhabitants is “rural” under the current definition, but if these loans are intended for communities, then a higher standard could be set, one that might include legal jurisdiction.

### Purpose of the Loans

If these loans are meant to stimulate the development of broadband access to areas that would not ordinarily be served by an unsubsidized market, then that purpose should be made clear. As part of the loan approval process, RUS should determine if the area is serviceable under ordinary market conditions. If so, then the loan could be refused and the market could take its course; if not, then a loan could be approved to connect a community that would not otherwise have access. Including such language in the definition would effectively prevent loans like those made in suburban Houston.

### General Field Representative’s (GFR) Role

More authority might be vested in the GFR to determine whether a borderline community qualifies as rural or not. Though GFRs should certainly be issued more specific guidelines, their assessment might help RUS arrive at a correct decision in unusual circumstances.

Until RUS administers the program with a more precise definition of “rural area,” more loans will likely be issued to suburban development projects. RUS has recently created a fourth definition of “rural area”; however, this new definition makes “area” more general (any identifiable place that has fewer than 20,000 inhabitants) and still considers population as its sole standard. This revision will not, in our opinion, help prevent loans intended for rural areas from being issued to affluent suburbs.

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<sup>36</sup> GAO, “Rural Housing: Changing the Definition of Rural Could Improve Eligibility Determinations,” December 2004 (GAO-05-110).

We conclude that RUS should either revise the definition to exclude suburban communities from the broadband program or, if this should not prove feasible, seek legislative clarification of the communities the program is meant to serve.

## **Recommendation 1**

RUS should obtain an Office of the General Counsel (OGC) opinion concerning its ability to restrict the law's definition of an eligible rural area.

### **Agency Response.**

In all three cases involved with developing the definition for a rural area as defined by the statutes in place at that time, the Telecommunications Program worked very closely in developing the definition with OGC. The Telecommunications Program had numerous discussions with OGC on the interpretation of the statutes, and the results were definitions agreed to by both the Telecommunications Program and OGC. Even if OGC were to opine that the agency could restrict the definition narrower than Congress intended, it would still be a matter of policy as to what restrictions, if any, should be imposed.

### **OIG Position.**

We fully understand that the responsibility of determining how broadly or narrowly "rural" should be defined lies with RUS management. Our recommendation neither states nor implies that RUS should make the definition "narrower than Congress intended"; instead, OIG maintains that Congress's current language was meant to serve only as a broad definition for bringing broadband service to rural citizens, and that the clear purpose behind the program was to fund service to the truly rural. We do not believe Congress foresaw that this broad definition might be used to justify funding loans to affluent suburban communities while other more rural communities remained underserved. By focusing this definition—if OGC concludes that it may do so—RUS will bring the broadband programs in line with the Congressional purpose of serving rural areas that would not, without Government assistance, have access to broadband.

To achieve management decision, RUS needs to obtain a written opinion from OGC concerning whether RUS can revise its definition of an eligible rural area to more fully correspond to the law's purpose. If OGC agreed with RUS in prior correspondence that the current definition of rural is the best possible, RUS should also provide OIG with documentation supporting that decision. RUS should provide timeframes for accomplishing these actions.

## Recommendation 2

If OGC concludes that RUS may restrict the law's definition of an eligible rural area, then RUS should develop and implement a definition of an eligible rural area that includes, as part of its criteria, a community's population density and distance from metropolitan areas. If OGC concludes that RUS may not, on its own authority, restrict the definition, then RUS should seek legislation to clarify the program's definition of an eligible rural area.

### Agency Response.

Again, as stated above, it would still be a matter of policy as to what restrictions, if any, should be imposed, regardless of OGC's legal opinion. As the audit report indicates, the FY 2004 Appropriations Act lifted the restriction of the 2002 Farm Bill that precluded the Telecommunications Program from considering areas eligible for funding that were included in any standard metropolitan statistical area. Prior to this, the Telecommunications Program did not fund communities that this report now brings into question. It was clearly Congress's position that the definition of a rural area be as broad as possible to cover as many rural citizens as possible.

### OIG Position.

RUS' response to the recommendation is unclear. To reach management decision, RUS needs to acknowledge whether it will commit to focusing the definition of an eligible rural area as described in our report. If the OGC opinion received to address Recommendation 1 of our report determines that the agency does not have the authority to change the definition of rural, then RUS needs to specifically acknowledge whether it will commit to seeking legislative clarification of the program's definition of an eligible rural area. RUS should provide OIG timeframes for the planned actions. (Also see OIG Position for Recommendation 1.)

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## Finding 2

### **RUS Needs Stronger Controls to Prioritize Communities Without Broadband Access**

RUS has not ensured that communities without broadband service receive first priority for loans. Although RUS does have a system in place for prioritizing loans to communities without access to broadband services, that system lacks a cutoff date and functions as a rolling selection process—priorities are decided based on the applicants who happen to be in the pool at any given moment. Until RUS makes loan priority decisions from the entire pool of applicants for any given period of time, the agency will not truly be giving preference to those communities without access. Further,

RUS has devoted a significant portion of its resources to funding competitive service in areas with preexisting broadband access rather than expanding service to communities without access. Our sample of 11 funded loans for 2004 showed that 66 percent (159 of 240) of the associated communities (i.e., all communities associated with one loan) had existing service. These 11 loans fostered competition among service providers in 42 percent of the associated communities.<sup>37</sup>

### RUS Needs a Cutoff Date for Broadband Loan Applications

Regulations establish three levels of priority for companies applying for broadband loans, based on the communities they propose to serve: (1) communities without broadband service; (2) communities where broadband access is available, but the quality of the service is inferior or the cost of the service not comparable to neighboring areas; (3) communities where new providers will compete with preexisting broadband companies.<sup>38</sup>

Regulations<sup>39</sup> also state that RUS will evaluate completed applications meeting the criteria for priority in order to expedite their processing, and evaluate the priority classification of applications on hand at least quarterly.

RUS' current system for prioritizing loans works as a rolling selection process: judgments concerning which loans will receive priority are based on the applications waiting for processing at any one time. An applicant may request priority by certifying that service is not available in any community—RUS then moves that application to the front of its queue awaiting approval. As part of the loan approval process, the agency verifies whether or not service is available in the proposed service area. If service is not available, the applicant is given first priority; if service is available, the application is denied first priority, placed in the queue by its date, and considered as a second or third priority.

So long as RUS has ample funds available for all approved applications, this method of prioritizing applications will suffice. Should RUS begin approving more applications than it can fund, the current system for determining priority may result in applications of second or third priority receiving funds before those of first priority. As funds become more sought after, second- and third-priority applications might receive funds while approved first-priority applications go without.

As an example, RUS might process, approve, and fund many broadband loans during the first half of an application period—some of these would be first-priority loans while others would be second and third priority. If funds

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<sup>37</sup> RUS calculated that 31 percent of the communities involved in all approved loans since 2003 had preexisting competitive service. When RUS calculates this figure, it only considers communities where competitive service exists and not communities where loans have been made to upgrade or expand service.

<sup>38</sup> 7 CFR 1738.15(c) and 7 CFR 1738.11(b), dated January 30, 2003.

<sup>39</sup> 7 CFR 1738, Background, dated January 30, 2003.

ran out, however, and other first-priority applications were received later in the period, those applications would go without funds while applications of lower priority from earlier in the application period had been granted.

During the 2001 pilot loan program this situation occurred. Even though first-in, first-out processing of applications was allowed during the pilot program, it supports our scenario of what can happen when applications exceed funds. Because of limited funds for the 2001 pilot loan program, RUS had to turn down many applications. We reviewed 38 letters of rejection and were able to contact 4 of the applicants. We found that these 4 applications were for extremely rural communities with no broadband service that would have been classified as first priority under the current system. Therefore, these communities would have received funding instead of some of the less needy communities (second and third priorities) that did receive funding as discussed in Finding 1.

We conclude that RUS' current system for prioritizing applications cannot ensure preference for communities without access to broadband, particularly if more applications are approved than the agency can fund.

#### Broadband Loans Have Fostered Competition Rather Than Expanding Access

In its statements before Congress, RUS has resorted to the letter of the law to defend the practice of making loans to competing broadband providers in rural areas. The law, however, states only that priority shall be given to "eligible rural communities in which broadband service is not available to residential customers." RUS interpreted this language to mean that, after it had served those communities without existing service, it might issue loans to communities with preexisting service. The law itself, however, does not mention or condone the practice of making loans to competing providers—it certainly does not require RUS to make such loans.

In writing regulations for the loan programs, RUS codified the practice of issuing loans to competing rural broadband providers, as shown in the three levels of priority mentioned above. As a result of following these regulations, many loans were issued to competing broadband providers: RUS calculated that 31 percent of the agency's loans served to foster competition in areas with preexisting service rather than extending service to communities without access. However, our sample of 11 funded loans for 2004 showed that 42 percent of the communities already had competing providers. In some cases, loans were issued to companies in highly competitive business environments where multiple providers competed for relatively few customers. For example, one borrower received a \$15.6 million loan to expand broadband service to a North Dakota town. Although the town's population numbers just 15,527, 4 other companies also were providing broadband access, some with Government assistance

and some without. Although RUS has followed its own regulations in issuing these loans, questions asked by the Congressional Rural Caucus's Committee suggest that—for some lawmakers, at least—this use of Federal funds contradicts the program's primary purpose.

Based on our review, we also question whether the Government should be loaning money for competing services. Such loans raise several troubling issues. *Can the sparsely populated rural areas for which these loans are intended reasonably support multiple broadband service providers?* RUS does not conduct objective market research to determine if competing providers are viable in a given community. Without such research, we found that RUS may be issuing loans to companies with little chance of survival. In one case, we reviewed a \$4.3 million loan in default; the GFR, who had not visited the area prior to the loan's issuance, concluded after the borrower defaulted that the company had failed due to competition. Approving loans likely to fail would not appear to be a suitable use of Federal funds. *Next, what is the Government's responsibility if, due to subsidized competition, a preexisting, unsubsidized broadband provider goes out of business?* If RUS continues issuing loans to competing providers, it is likely this question will have to be answered. *Finally, from the perspective of equity, why should the Government subsidize some providers in a given market and not others?*

Based on its answers to these questions, RUS should determine if the practice of issuing loans to competing providers should continue.

### **Recommendation 3**

Establish and implement cutoff dates to ensure that applications are evaluated for priority at least every quarter.

#### **Agency Response.**

CFR 1735.15(c) currently requires that all broadband applications that have been submitted be prioritized for processing on a quarterly basis. Because of the funding levels currently available for the Broadband Program, the Telecommunications Program has been able to evaluate and prioritize as necessary each application when it is submitted. Whenever an application for an unserved area is submitted, it is processed before all other applications, regardless of when the other applications were submitted.

#### **OIG Position.**

Regardless of funding levels, RUS should establish and implement cutoff dates to ensure that applications are evaluated for priority at least every quarter as required by its regulations, and provide OIG timeframes for such actions.

## **Recommendation 4**

Cease providing loans to competing broadband providers until RUS has reviewed past loans made in competitive environments. That review should determine if these loans have given funded providers an unfair financial advantage over those without RUS funds, or have otherwise adversely and materially affected the success of these loans.

### **Agency Response.**

The Telecommunications Program's implementation of the Broadband Program is in accordance with the statutes that established the program. Both the 2002 Farm Bill and the President's broadband initiative identify the need for competition to increase the quality of services and reduce the cost of those services to the consumer.

### **OIG Position.**

The authority initiating the pilot loan program stated that the President of the United States and the United States Congress made funds available through a 1-year pilot program to encourage broadband service to rural consumers where such service does not currently exist. Also, the 2002 Farm Bill stated the Secretary shall give priority to eligible rural communities in which broadband service is not available to residential customers. Further, RUS' response is unclear in addressing the recommendation. To reach management decision, RUS needs to cease making loans to competing broadband providers until they have completed a review to determine the effect of RUS loans made in a competitive environment. RUS needs to specifically acknowledge whether it will commit to performing a review to determine the consequences of creating competitive environments in these rural areas. RUS also should provide timeframes for the planned actions. We suggest that RUS consider obtaining input and guidance on this issue from its Policy Analysis and Risk Management Division and other sources, as necessary, to determine the feasibility of creating competition in areas that may well have problems supporting one broadband server, much less several.

## **Recommendation 5**

Based on the results of this review, RUS should determine if its practice of issuing loans to competing broadband providers should continue and take appropriate action.

### **Agency Response.**

The Telecommunications Program will implement any changes to the statute that are approved by the President and Congress.

### **OIG Position.**

RUS does not need statutory change to evaluate this issue. To reach management decision, RUS needs to cease making loans to competing broadband providers until it has completed a review to determine the effect of RUS loans made in a competitive environment. RUS needs to specifically acknowledge whether it will commit to performing a review to determine the consequences of creating competitive environments in these rural areas. Based on the results of the review, RUS should determine if its practice of issuing loans to competing broadband providers should continue and take appropriate action. Also provide timeframes for the planned actions. We suggest that RUS consider obtaining input and guidance on this issue from its Policy Analysis and Risk Management Division and other sources, as necessary, to determine the feasibility of creating competition in areas that may well have problems supporting one broadband server, much less several.

## **Section 2. Administration and Management Controls**

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In the 4 years RUS has administered the Broadband Grant and Loan Programs, the agency has not adopted a management structure capable of providing those programs with unified guidance. In particular, RUS has not developed and implemented specific written procedures for approving and servicing broadband grants and loans. Due to irregularities occasioned by these control weaknesses, \$236.6 million, or 26 percent of total program funds, has been used inefficiently, has not been used at all, or has not produced the expected return in service.

Moreover, by keeping grants separate from the loan program, RUS has made it more difficult for administrators to arrive at a global understanding of which communities have already received Federal funds, information that is essential if RUS is to allocate its resources effectively. Similarly, the agency's information technology does not facilitate informed program decisions for grants and loans, both before and after funds are advanced. In some cases, flaws in the current management information system have meant that RUS has provided inaccurate information regarding the broadband programs.

In sum, the agency lacks the management controls necessary to ensure that communities receiving broadband funds are, in fact, those needing it most, and that those receiving grants and loans use those funds as agreed.

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### **Finding 3**

#### **RUS Needs Controls Over the Approval and Servicing of Broadband Grants and Loans**

Although RUS has administered the Broadband Loan and Grant Programs for several years, the agency has not yet established specific written procedures to supplement the implementation of regulations. RUS' general approach to administering these programs can be described as piecemeal and patchwork—one agency official described the pilot loan program as a “very risky venture” administered through a process of “trial and error.” Following this operational approach, the agency did not institute required management controls for the consistent and correct processing and servicing of approximately \$895 million in Federal broadband grants and loans.<sup>40</sup> Agency officials generally felt, particularly given their limited resources and personnel, that their previous experience with similar programs would suffice for administering the broadband programs. Due to irregularities resulting from this decision, however, we found that \$236.6 million in

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<sup>40</sup> Instead, to govern these programs, RUS issued Notices of Funds Availability for pilot loans and grants; in January 2003, RUS published regulations for the Broadband Loan Program, and in July 2004, it released the regulations for the Community Connect Grant Program.

grants and loans was either used inefficiently, not used at all, or did not result in the expected return in broadband service.

Departmental manuals require that GAO's "Standards for Internal Control in the Federal Government" be used for establishing and maintaining management control systems.<sup>41</sup> These standards state that agencies should establish appropriate documentation for internal controls such as management directives, administrative policies, or operating manuals.<sup>42</sup>

The absence of such controls resulted in a number of irregularities in RUS' processing and servicing of grants and loans:

- 1) \$137.4 million<sup>43</sup> in loans was approved even though the borrowers' applications were incomplete or inaccurate;
- 2) \$2.7 million in grants was made to one company that then deviated from the planned use as stated in the grant agreement (RUS advanced over \$1.9 million to this company; \$762,226 in additional grants slated for the same company is at risk should it be released);
- 3) \$30.4 million in loans was in default due to inadequate servicing;
- 4) \$59.3 million in approved grants and loans has never been drawn down and used; and
- 5) \$6.8 million in cancelled loans was not put to use in a timely fashion and was therefore unavailable for future funding.

In sum, we question the use of \$236.6 million in broadband grants and loans.

**Grant and Loan Application Processing**—On the whole, RUS' application review process was relatively consistent and sufficient to identify that some applications were ineligible, especially considering the absence of specific written standard operating procedures. In FY 2004, for example, RUS determined that 117 of 158 grant applications were ineligible for a variety of reasons, including multiple communities listed in the application, the absence of required budget documents, and preexisting broadband service in the community in question. For 2003 to 2005 loans, RUS questioned 67 of the 128 applications, concluding that 34 were ineligible and 33 were incomplete. The main reasons for these determinations were insufficient credit support, incomplete applications, insufficient market surveys and failure to meet financial requirements. We found, however, several instances where clear, coherent procedures would have improved RUS' ability to administer the broadband programs.

*Grant Processing*—Based on our review of 17 of 74 approved applications for FYs 2002 and 2003 pilot grant program and all 16 of the funded applications for FY 2004 grant program, we question the

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<sup>41</sup> Departmental Manual (DM) 1110-2, *Management Control Manual*, chapter 2, section 3 – Management Control Standards, dated November 29, 2002.

<sup>42</sup> GAO, *Standards for Internal Control in the Federal Government*, Control Activities Section, dated November 1999.

<sup>43</sup> See footnote 2.

consistency of the review process for 7 of the 17 funded pilot applications and 5 of the 16 funded grant applications.

RUS should, in particular, specify that the same team will review all applications from any given company. To score the pilot grant applications, RUS establishes two-person teams consisting of a RUS engineer as well as a RUS management representative. Because applications from the same company were reviewed by different teams, we found that discrepancies were not identified prior to the grant being advanced. These discrepancies included substantive misrepresentations on the part of company B (see subheading below entitled “Grants Not Properly Serviced”). In each application, company B proposed to place antennas on water towers for broadband services in that community. However, only one application file contained pictures and addresses of the correct water towers for that community. The other six files contained discrepancies such as pictures of the same water towers in different communities (see exhibit D). After the changes in RUS’ review process were implemented in 2004, officials stated that they try to ensure that the same two-person team reviews multiple applications from the same applicant. Nevertheless, to ensure consistency, RUS should institute this procedure in its written staff instructions.

GFRs’ initial visits also failed, in some instances, to determine that communities already had preexisting broadband service. Though three of the seven communities on company B’s applications already had access to broadband, the GFR did not recognize this fact, which would have rendered those applications ineligible.

We noted that the employees rating the FY 2004 grant applications differed on applicant or project eligibility in 5 of the 16 applications in our sample. RUS has comprehensive grant application checklists to determine eligibility and completeness, a scoring worksheet, and a section for summary comments on the project, yet the employees rating applications had not received formal training for reviewing applications. Instead, their training consisted of oral briefings by RUS Headquarters staff. Even though these discrepancies were later corrected and the correct determination made, we believe that these employees need further training to consistently apply the guidelines in RUS’ review guide.

*Loan Processing*—Although loan personnel processed applications relatively consistently given the lack of management controls, our review found two instances where specific standard operating procedures would help increase program efficiency. The agency needs, in particular, to institute procedures preventing incomplete or inaccurate loan applications from reaching the approval committee. Based on our review of 13 of 28 approved pilot loans (FYs 2001 and 2002) and 15 of

36 approved loans for the loan program (FYs 2003 through 2005), we found problems with the approval of 2 loans totaling \$137.4 million.<sup>44</sup> One loan was approved even though the application lacked a market survey, business plan, or complete certified system design. The second loan application misrepresented the results of the provider's market survey.<sup>45</sup> Until RUS possesses a complete and accurate application, it cannot assess the financial feasibility of the project, the company's ability to pay back the loan, or whether the provided quality of service would meet the agency's standards.

**Grants Not Properly Serviced**—Because the agency lacks established procedures for servicing grants after they have been advanced, RUS did not maintain sufficient oversight to determine whether projects receiving grants used the funds appropriately. Until RUS services these grants in a more thorough manner, it cannot be certain that grant funds are being used to meet program goals.

*GFR Field Visits Inadequate*—For seven pilot grants totaling \$2.7 million, we found that the GFR did not perform sufficient field visits for RUS to detect that company B had submitted information conflicting with its planned use of grant funds. As a result, company B may have improperly used over \$1.9 million in advanced grant funds, while the remaining \$762,226 of obligated funds could be at risk if released.<sup>46</sup>

Although company B's budget in one application showed expenditures for antennas to be erected on the community's two water towers, the county project manager stated that company B would be "piggy backing" off existing antennas on the community's water tower rather than installing its own. Further, the application gave two separate addresses for the two towers with a combined rent of \$36,000 (\$18,000 each) for 2 years. Although the contracted amount for tower space remained at \$36,000, company B only contracted for one tower in the community, and there was no evidence in the file showing that the borrower notified RUS of the changes. The company's grant agreement stated that it would obtain prior written approval from RUS for any material change to the grant project including changes to the system design or scope of the work. Renting a single existing tower rather than erecting two of its own—and still paying a total rent of \$36,000—constitutes, in our opinion, a material change to the system design and the scope of the work. We conclude that these deviations could have been detected through timely and thorough GFR visits and compliance reviews.

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<sup>44</sup> See footnote 2.

<sup>45</sup> In the market survey, 65 percent of adult residents stated that they do not need broadband service; 75 percent stated that they would not sign up for the service in the next year. The provider nonetheless concluded that the community wanted its services.

<sup>46</sup> Fund amounts are as of March 8, 2005.

*Final GFR Visits Not Always Performed*—RUS considered projects complete only because all funds had been drawn down. According to the agency’s determination, seven broadband grant projects have been completed. We found, however, that only two of the required field visits were done to verify actual project completion. Thus, the agency cannot be certain that the funds drawn down were used according to the grant agreements, or that the project was completed at all.

*Regular Compliance Reviews Not Performed*—RUS’ Program Accounting and Regulatory Analysis Section did not perform regular compliance reviews of the Broadband Grant Program as specified by Departmental regulations and GAO standards.<sup>47</sup> Currently, RUS does not consider that the grant program has sufficient funding to warrant regular compliance reviews; RUS officials stated that they were nonetheless instituting procedures to include these reviews.

RUS had only completed compliance reviews on two grant projects; the review for one grantee (company B) was initiated because of OIG’s audit. RUS completed this review in April 2005 and determined that there were substantial findings and disallowances on all seven of the grants for company B. In all, RUS found that over \$900,000 of the funds were used for profit. The use of funds for profit violated the grant agreement, and regulations require that RUS should have suspended or terminated the grant.<sup>48</sup> Nonetheless, the agency has not done so.

**Pilot Loan Funds in Default**—Due to the absence of written procedures specific to the program, we found similar problems with how pilot loans were serviced after approval. Of the 28 approved pilot loans, 6 were in default with \$30.4 million in outstanding principal. Had the progress of these projects been timely and thoroughly monitored, RUS might have been able to avoid advancing loan funds to companies that were failing. Because these loans were not carefully serviced,<sup>49</sup> these funds are not available to support future broadband loans.

Without any written procedures, RUS did not timely obtain or review independent annual audit reports for loans. Although RUS officials stated the agency’s new loan agreements would now require quarterly financials from borrowers that should help detect companies in danger of defaulting on their loans, we had no opportunity to evaluate the servicing of FY 2004 loans because meaningful information was not yet available. We noted that

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<sup>47</sup> Departmental regulations state that GAO’s “Standards for Internal Control in the Federal Government” provide standards for use in establishing and maintaining systems of management control (DM 1110-2, *Management Control Manual, chapter 2, section 3, - Management Control Standards*, dated November 29, 2002). GAO standards state that internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved (GAO, *Standards for Internal Control in the Federal Government*, Control Activities Section, dated November 1999).

<sup>48</sup> 7 CFR 3015.122(a), dated November 10, 1981.

<sup>49</sup> We found that these loans had one or more of the following servicing deficiencies: the independent annual audit report had not been issued; the annual audit report had been issued, but had not been received until after the loan was in default; the GFR did not visit until after the loan was in default; or the Loan Fund Accounting Representative detected problems before the default, but no action was taken.

one of the defaulted borrowers with a pilot loan also received a pilot grant.<sup>50</sup> RUS had not reviewed the grant-funded project to determine its viability. Therefore, the grantee (i.e., defaulted borrower) may be jeopardizing the intended use of the grant funds as well.

**Pilot Loan and Grant Funds Were Not Drawn Down**—RUS has not exercised timely oversight of approved grant and loan projects to ensure that all obligated funds were drawn down and used for the agreed-upon purpose. For pilot loans and grants, RUS has established a general policy that companies have 3 years to draw down all obligated funds. This period is not statutory or regulatory in nature, and depends instead on the grantee's or the borrower's project needs. Though this time period may be reasonable, RUS does not verify that companies' projects remain viable and are progressing as planned. As a result of this lack of oversight, \$37 million of the \$59.3 million<sup>51</sup> not drawn down is therefore not available for future funding.

For the pilot loan program (FYs 2001 and 2002), the borrowers for 18 of 28 approved loans totaling \$180 million have not drawn down all obligated funds totaling over \$53.8 million. Further, 11 of the 18 loans with almost \$37 million<sup>52</sup> of obligated funds have gone past the 3-year limit to draw down funds. Because these situations have not been dealt with in a timely manner, these funds are not available to support future broadband loans.<sup>53</sup>

For the pilot grant program (FYs 2002 and 2003), 20 of 74 grants obligating \$32 million have not drawn down any of the grant funds. In addition, 14 grantees are not attempting to construct their broadband projects, resulting in a total of \$5.5 million going unused. Although none of these grants has exceeded the 3-year timeframe, RUS indicated that some of the funds are not going to be used, but has not yet deobligated them. For example, even though RUS acknowledged they were aware that \$440,000 of grant funds was issued to a community unable to enter into an agreement,<sup>54</sup> it has not taken steps to deobligate the grant and put the funds to better use.

Timely oversight of these loan and grant projects could have detected whether projects were progressing as planned. Especially when funds had not been drawn down for months, visits should have been performed to evaluate the continuing viability of the project. In some cases, RUS should have acted and reobligated funds for other applicants.

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<sup>50</sup> A company may be issued both a loan and a grant if the community being served by the grant differs from the community being served by the loan.

<sup>51</sup> As of March 2005.

<sup>52</sup> About \$4 million of these funds was reported above for the defaulted pilot loans.

<sup>53</sup> The source of funds determines their eligibility. RUS can cancel and reloan discretionary funds, like those expended for the pilot programs, within a period of eligibility associated with certain sums of money. All pilot funds have, at present, exceeded their period of eligibility. Thus, if they have not yet been drawn down, those funds are no longer available to support the broadband programs.

<sup>54</sup> The community was, in this case, the grantee. The community's own policies prohibited it from entering into a grant agreement.

**Cancelled Loans Not Put to Better Use**—Another \$6.8 million in pilot loans was approved but then cancelled when it became apparent that the companies to which they were issued were not going to use the funds.<sup>55</sup> RUS was not able, however, to reobligate those funds to companies better able to use the loans because the agency had not acted within the time period established by Congress. Though such cancellations will occur, RUS does not have a system in place to timely identify and reallocate funds that will otherwise go unused.

We conclude that RUS, in order to ensure that funds are used as efficiently as possible, needs to develop and implement written controls for approving and servicing broadband grants and loans.

## **Recommendation 6**

Develop and implement written guidance for the Community Connect Grant Program including the following:

- application review and rating;
- training for reviewers;
- GFR requirements for project visits;
- monitoring project activity and completion (including compliance reviews); and
- suspension or termination in accordance with regulations.

### **Agency Response.**

Although the Telecommunications Program has implemented a number of the oversight items listed in the audit report (i.e., worksheets for reviewing and scoring a grant application have been developed, training is provided to the reviewers each year at the start of the review process, advance of grant funds is suspended when improprieties are identified, etc.), the audit report is correct in its findings that the oversight procedures have not been documented in the form of staff instructions. The Telecommunications Program is committed to the development and implementation of written guidance for the Community Connect Grant Program.

The Telecommunications Program will complete the following tasks by March 30, 2006.

- ✓ Develop staff instruction for reviewing and scoring grant application.
- ✓ Develop staff instruction transmitting and clearing grant documents.

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<sup>55</sup> \$152,669 was rescinded because the borrower received a loan under a special 9/11 program; \$2,104,000 was cancelled because the entity decided (13 months later) not to provide the service; and \$4,536,295 was cancelled because the borrower decided in 2004 to use a Farm Bill loan for the community.

- ✓ Develop staff instruction for advance of grant funds.
- ✓ Develop staff instruction for GFR oversight of grants.
- ✓ Develop staff instruction for servicing of grants.
- ✓ Develop staff instruction for rescission and reobligation of grants.

**OIG Position.**

We concur with the management decision for Recommendation 6. To achieve final action, RUS needs to send OCFO/PAD documentation that the above-mentioned written guidance was completed by March 30, 2006.

**Recommendation 7**

Develop and implement written guidance for the Broadband Loan Program including the following:

- applications to be reviewed and approved;
- GFRs to perform periodic reviews to ensure the proper use of funds and the viability of projects;
- independent annual audit reports to be obtained and reviewed;
- quarterly financial reports to be obtained and reviewed;
- recommendations from GFR reports and compliance reviews to be analyzed and acted upon; and
- applications and supporting documents to be complete before the applicant is approved.

**Agency Response.**

The Telecommunications Program has recognized the need to develop and implement written guidance for the Broadband Loan Program and has started the process of formalizing the procedures that are currently in use.

To date, the Telecommunications Program has completed the following staff instructions:

- ✓ Initial log-in procedures when an application is received.
- ✓ Procedures for the initial financial review of an application.
- ✓ Procedures for the initial engineering review of an application.

In addition, the Telecommunications Program is in the final stages of completing the development of a loan feasibility model and the corresponding instructions for using this model. The projected completion date for full implementation of this model is October 30, 2005.

It should also be noted that the Telecommunications Program is in the process of developing a database to monitor the performance of all companies that are issued a loan. The database will track actual quarterly financial statistics against projected financial statements and will monitor the ongoing health of the operation. As part of this effort, a system is being developed that will allow each borrower to electronically submit the required quarterly financial reports. This project is scheduled for completion by January 30, 2006.

The Telecommunications Program is committed to completing the development and implementation of written guidance for the Broadband Loan Program. The Telecommunications Program will complete the following tasks by March 30, 2006.

- ✓ Staff instruction for the detailed financial review of an application.
- ✓ Staff instruction for the detailed engineering review of an application.
- ✓ Staff instruction for assembling the loan packet that will be presented to the credit committees for loan approval.
- ✓ Staff instruction for preparing and clearing the legal loan documents.
- ✓ Staff instruction for GFR oversight of the broadband loans.
- ✓ Staff instruction for servicing of the broadband loans.
- ✓ Staff instruction for rescinding and reobligating loans.

#### **OIG Position.**

We concur with the management decision for Recommendation 7. To achieve final action, RUS needs to supply OCFO/PAD documentation that the above-mentioned actions have been completed by the dates indicated.

#### **Recommendation 8**

Recover advanced grant funds of \$1,936,046 from company B.

### **Agency Response.**

The Telecommunications Program has completed an accounting audit of company B and is in the process of recovering all funds that were not accounted for properly.

### **OIG Position.**

We agree with the action taken. However, to reach management decision, RUS needs to provide documentation showing an accounts receivable has been established and that the borrower has been billed for the unauthorized use of grant funds, and timeframes for such actions.

## **Recommendation 9**

Deobligate the remaining grant funds of \$762,226 from company B.

### **Agency Response.**

The Telecommunications Program has suspended advances of all remaining grant funds for company B. The Telecommunications Program is currently reviewing this situation and will take all appropriate action.

### **OIG Position.**

We agree with the action taken. However, to reach management decision, RUS needs to provide documentation showing what actions it will take to deobligate the funds, and the timeframes for doing so.

## **Recommendation 10**

Recover the \$30,377,069 for the six defaulted pilot loans.

### **Agency Response.**

All of these loans have been transferred from the Broadband Division to the Policy Analysis and Risk Management Division. The Policy Analysis and Risk Management Division is responsible for working with borrowers that are in default and recovering the outstanding loan balances. The Policy Analysis and Risk Management Division is currently working with each of the six borrowers in question.

### **OIG Position.**

We agree with the action taken. However, to reach management decision, RUS needs to provide documentation showing timeframes for actions that will be taken to recover the funds, or provide justification for not doing so.

## **Recommendation 11**

Review all loans and grants that have not drawn down funds and determine whether proposed projects are still viable. If the projects are not viable, deobligate the funds.

### **Agency Response.**

For the Pilot Broadband Loans, the Telecommunications Program is in the process of completing a review of all borrowers with unadvanced funds. Once this review is completed, the Telecommunications Program will make a determination if the funds are still required. Any funds that are not required will be deobligated.

For the Farm Bill Broadband Loans, all loans have an initial 5-year period to draw down funds. All of these loans are still within this period. When one of these loans reaches the end of the 5-year period, a financial analysis will be completed if funds remain unadvanced to determine if they are still required and can be supported by the operation.

For the Community Connect Broadband grants, all grants have a 3-year drawdown period. The Telecommunications Program will initiate a review of all grants that have exceeded the timeframe to draw down funds. All funds that are not required to complete the projects or cannot be supported by operations will be deobligated.

### **OIG Position.**

We agree with the action taken. However, to reach management decision, RUS needs to provide its timeframes for completing these reviews.

## **Recommendation 12**

Establish and implement procedures to ensure cancellation and reobligation of unused grant and loan funds within the time periods specified by Congress.

### **Agency Response.**

The Telecommunications Program currently has procedures in place to cancel and reobligate grant and loan funds. Written procedures will be developed as part of the action items included in the agency's response for Recommendations 6 and 7.

## **OIG Position.**

We concur with the management decision for Recommendation 12. To achieve final action, RUS needs to send OCFO/PAD a copy of its written procedures.

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### **Finding 4**

#### **RUS Needs to Unify Its Administration of Broadband Grants and Loans**

RUS' system for administering broadband grants and loans is not unified and does not facilitate informed, global management decisions about the program as a whole. Because RUS has not considered the grant program permanent, it has maintained a divided management structure, requiring that grant and loan applications be processed by different personnel. This division has resulted in grants being issued to a community where a loan had already been provided, in direct violation of grant provisions. RUS' Acting Assistant Administrator has explained that this division is due to the Broadband [Loan] Division's lacking sufficient staff to handle both loans and grants. This management structure might be tenable if RUS possessed an effective, unified information system for monitoring loan and grant information and distributing that information to both groups of employees. However, RUS' current information system is not equal to this task and cannot help management make the most informed funding decisions possible. Shortcomings in this information system have meant that RUS' management has made decisions based on incomplete and inaccurate information. On the whole, this organizational arrangement lessens the assurance that the broadband programs' purposes are being accomplished consistently.

GAO's "Standards for Internal Control in the Federal Government" provide Departmentwide rules for establishing and maintaining management control systems.<sup>56</sup> According to GAO, effective management of an organization's workforce is essential to achieving results and an important part of internal control. Only when personnel are provided the right training, tools, structure, incentives, and responsibilities is operational success possible.<sup>57</sup> GAO standards also state that for an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events. The agency also needs up-to-date, accurate information to determine whether it is complying with various laws and regulations.<sup>58</sup>

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<sup>56</sup> DM 1110-2, *Management Control Manual*, chapter 2, section 3 – Management Control Standards, dated November 29, 2002.

<sup>57</sup> GAO, *Standards for Internal Control in the Federal Government*, Control Activities Section, dated November 1999.

<sup>58</sup> GAO, *Standards for Internal Control in the Federal Government*, Information and Communications Section, dated November 1999.

### Divided Management Structure—

Grants are not currently united with loans under the Broadband Division. RUS has kept grants and loans separate because the Presidential budget does not include funding for broadband grants; instead, since FY 2002, Congress has appropriated these funds. Since these appropriations may not continue, RUS does not consider the grant program permanent and does not believe that incorporating loans and grants under the same division would be practical, especially given the personnel shortages its Broadband Division is experiencing.

Due to this arrangement, coordination problems occur between the divisions—loan personnel do not always know what grant personnel are doing and vice versa. We found, in one instance, that two separate companies received funding to provide broadband access to the same community. After a loan had already been issued to one company for \$3.3 million, a \$383,284 grant was approved to a second company providing service to the same community, even though grant program instructions specifically prohibit funding a community that already has service.<sup>59</sup> RUS officials explained that this situation might have occurred because the company receiving the loan had not yet started to build in the community before the grant was awarded; however, both the loan and the grant were approved with the clear intent of supplying the community with broadband service. Because of its divided management structure, the agency was not aware that it was, in effect, funding competitive services, nor was any objective market research performed to determine if the community could support two broadband services. A management information system capable of bridging this administrative divide would help to eliminate these problems, but, as we discuss below, RUS' information technology is not equal to the agency's needs.

Given the dangers we have touched on concerning competition between broadband providers in rural areas (see Finding 2), we conclude that RUS needs a unified management structure capable of seeing exactly what grants and loans it has provided to any given community. Though the grants may not be permanent, so long as Congress is appropriating funds for them, RUS needs a management structure capable of properly coordinating Federal grants and loans.

### Management Information System—

Several weaknesses in RUS' information system prevent the agency from managing loans and grants based on the most timely and accurate information. The current database used for monitoring loan applications does not include all grant and loan information since the pilot programs' inception; it does not accurately list all communities that have received

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<sup>59</sup> *Federal Register*, Vol. 67, No. 130, "Notice of Funds Availability," dated July 8, 2002.

broadband grant and loan funds; and it does not monitor all relevant servicing activities. Due to these shortcomings, RUS cannot, without manually reviewing all loan and grant files, determine how the broadband programs are performing.

*Database is Incomplete—*

RUS' database contains broadband loans made for FYs 2003 through 2005, but information from the pilot loan program in FYs 2001 and 2002 is not included. No information for broadband grants is contained in the database. Any comparison between loan and grant information must be accomplished manually between the separate divisions. Because manual coordination between the divisions does not (as our aforementioned example indicates) always occur, grants may be issued to communities where loans have previously been made.

*Funded Communities Are Not Accurately Represented—*

The Broadband Loan Program's database does not accurately identify all funded communities: it fails to list some communities receiving funds and lists other communities not receiving funds. When a community is not listed in the census, RUS designates that community only as a "rural area." Since part of the database's purpose is to alert agency officials to cases where communities would receive duplicate funding, this "rural area" designation is too vague to be useful—one cannot determine from the database alone whether or not a community has already received broadband funds.

Furthermore, if multiple communities within a county are not listed in the census, then the communities are often combined into a single "rural area." For example, our sample of 11 loans provided service to 240 communities, 30 of which were not in the census; therefore, RUS did not add the names of the communities to the Broadband Loan Program's database. In addition, only 12 of the 30 were identified by the designation of "rural area." Therefore, the other 18 communities were not identified by name or number in the database. Instead, they were combined with one or more of the 12 "rural area" designations due to being located in the same county. We conclude that this way of listing communities understates the total number of communities receiving RUS funds for broadband services.

In addition, the database lists some communities not funded by RUS loans. Companies making applications are required to list all the communities they will be serving even though some will not be funded by a RUS broadband loan. All these communities are nonetheless recorded in the database and could result in RUS overstating the total number of communities it has funded.

### *Servicing Activities Are Not Documented—*

The system does not track GFRs' project-related field visits. A more useful database would record and monitor schedules for GFR site visits, performance reports, and annual audit reports for each project. Without an effective tracking system, RUS cannot effectively determine whether: (1) required site visits are conducted, (2) projects are on schedule, (3) funds are used properly, and (4) performance reports are accurate.

RUS is in the process of improving its information technology. The current broadband database, established primarily to track loan application status, was introduced in February 2004. A RUS official stated that RUS was scheduled to bring online a new database capable of performing new processes. Both the new database and the existing database, however, only track loan applications from the time they are received until either they are denied or they are approved and funds are released. RUS also has started working on a third database, a loan portfolio management system that will monitor projected performance against actual performance. Though this new management information system may be an improvement over RUS' current system, it does not necessarily address the agency's need for a truly unified information system.

We conclude that RUS needs a unified management information system capable of capturing critical information across the entire range of the broadband programs. So long as broadband loans and grants are processed by different personnel, the agency's need for a management information system capable of sharing relevant data between these two distinct groups of personnel is all the more pressing. RUS should ensure that the revised databases include grant information, pilot program grants and loans, the names and total count of all funded communities, and project-related servicing activities.

### **Recommendation 13**

Align both the Broadband Loan Program and the Broadband Grant Program under the Broadband Division to promote accuracy in eligibility determinations when processing broadband loan and grant applications.

#### **Agency Response.**

Currently, the Advanced Services Division of the Telecommunications Program is responsible for completing the initial review and awarding of broadband grants. In addition to the broadband grants, the Advanced Services Division also is responsible for reviewing and awarding a number of other grant programs for which the Telecommunications Program is responsible. The Telecommunications Program believes that the expertise that this division has developed in reviewing and awarding grants is essential

to ensuring that all grants are awarded fairly and will continue to use the Advanced Services Division to review and award the broadband grants.

Once the Advanced Services Division has awarded the broadband grants, the grants are turned over to the Northern and Southern Divisions of the Telecommunications Program for servicing. Starting with the award of the broadband grants for FY 2005, the responsibility for servicing these grants will be transferred to the Broadband Division. The Northern and Southern Divisions will complete the servicing of the prior grants.

### **OIG Position.**

We commend RUS for shifting grant servicing under the Broadband Division; however, we believe the Broadband Division should also be responsible for the awarding of the grants. Please provide details on what actions are planned to ensure uniform approval and service of grants, as well as the timeframes for these actions.

## **Recommendation 14**

Develop and implement an integrated management information system that will track all loan and grant information from the date the application is submitted through servicing and project completion. The system also should include (a) all pilot loan and grant information, (b) identification of specific communities or locations for each loan or grant, and (c) dates and results of servicing activities.

### **Agency Response.**

The Telecommunications Program currently has an Access data base that tracks all 2002 Farm Bill broadband loans from the time the application is received until the application is deemed ineligible for funding or until funds are made available for advance. This database is being upgraded to a Structure Query Language database and will be brought on-line shortly.

In addition to the Structure Query Language database for applications, the Telecommunications Program is currently in the process of completing a database for the purpose of loan portfolio management of the Farm Bill loans. This database will be linked to the broadband application database.

The Telecommunications Program agrees with the audit report findings concerning the expansion of these databases. The Telecommunications Program will start the process of expanding these databases to include all relevant information for the pilot broadband loans and the broadband grants. This effort will include incorporation of the audit report's recommendations.

**OIG Position.**

We agree with the planned corrective action. However, to reach management decision, RUS needs to provide timeframes for implementation of the corrective actions described.

# ***Scope and Methodology***

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In order to review RUS' FYs 2001 through 2005 administration of the Broadband Grant and Loan Programs, we visited the RUS National Office in Washington, D.C., and examined loan and grant files for FYs 2001 through 2005, as of March 10, 2005.

To assess RUS' administration of the programs, we identified and examined its management controls over entity eligibility and application processing. Specifically, we reviewed financial and management records; statutes and acts applicable to broadband programs; and regulations, policies, and procedures at the national office that RUS used to administer the Broadband Grant and Loan Programs. We also conducted interviews with national office personnel and reviewed applications and supporting documents in the loan and grant files. We conducted our fieldwork from January 2004 through April 2005 in accordance with Government auditing standards and OIG policies and procedures.

Overall, we reviewed 33 of 90 funded grants totaling \$20.2 million of \$41 million, or 49 percent of the total funded amount. We also reviewed 28 of 64 funded loans totaling \$578.9 million of \$854 million, or 68 percent of the total funded amount.

- For the Broadband Pilot Grant Program (FYs 2002–2003), there were 318 applications submitted. Of these, 74 were funded totaling \$32.1 million, and we selected for review 17 totaling \$11.3 million. Also, we reviewed 28 additional applications—1 approved but not funded, and 27 not approved.
- For the Community Connect Grant Program (FY 2004), there were 158 applications submitted. Of these, 16 were funded totaling \$8.9 million, and we reviewed all 16. Also, we reviewed 12 additional applications—4 approved but not funded, and 8 ineligible.
- For the Broadband Pilot Loan Program (FYs 2001–2002), there were 61 applications submitted. Of these, 28 were funded totaling \$180 million, and we selected for review 13 totaling \$94 million. Also, we reviewed 6 returned applications.
- For the 2002 Farm Bill Broadband Loan Program (FYs 2003–2005), there were 128 applications submitted. Of these, 36 were funded totaling \$674.2 million, and we selected for review 15 totaling \$484.9 million. Also, we reviewed 10 returned applications.

We judgmentally selected funded loans and pilot grants to review based upon (1) the dollar amount of a loan or grant, (2) the location of proposed broadband services, (3) the timeliness of loan payments, (4) applicants receiving both a loan and a grant, and (5) services provided to numerous communities. All funded 2004 grant applications were reviewed. The additional grant applications were selected to determine the reason for denial and why approved applications had not been funded. We reviewed the rejection letters for the additional loan applications to determine why the applications had been returned. Also, we evaluated the scoring and ranking of grant applications.

We selected and visited 21 communities for 1 pilot loan and 9 pilot grant applications. Twelve communities were selected because of their close proximity to metropolitan areas, seven were selected because of the apparent discrepancies in the grant applications, and two were selected because of high per capita income. We did not visit the recipients to determine how funds were used.

We also performed an analysis on all loans and grants to determine funded communities' proximity to large cities. This analysis was performed based on our review of the pilot loan file for company A. The file contained an area map showing the subdivisions requested for funding were very near the outskirts of Houston, Texas. Our field visits confirmed this was true. Based on this, we performed an analysis to identify other communities near large cities. We used the Adobe Acrobat Portable Document Format file (dated February 10, 2005) on RUS' website, which listed all broadband loan and grant communities for approved and pending applications from FYs 2001 to 2005, as well as RUS' database to develop an Excel spreadsheet of all approved communities and the companies providing service. We then used the U.S. Census to determine the population of the communities, as well as the U.S. Cities website to determine proximity of the communities to large metropolitan cities with populations over 200,000. We selected all funded communities within a 30-mile radius from a city larger than 200,000. We then used a Rand McNally 2005 Road Atlas to further determine how close the communities were to the outskirts of the large cities. Although the U.S. Cities website did not indicate the point in the city from which distance had been measured, we concluded measurements were made from the center of the city based on the sample case in Finding 2. The website showed that one of the subdivisions for company A was about 30 miles from Houston. We knew based on our review of a Houston-area map, a visit to the subdivision, and an interview with a city official that the community was only 10 miles from the outer edge of Houston's city limits.

From this review, we identified 43 additional communities near 13 large cities in 10 States.<sup>60</sup> These communities were funded through 13 loans totaling over \$417.8 million. Although certain funds can be identified for a specific community, other funds are spent on common equipment that is used for all communities on the network; on a loan-by-loan basis, it would be necessary to itemize and evaluate each expenditure on each loan. To assign estimated dollar amounts to these questioned communities, we divided the total loan amount by the total communities being funded, and applied the result to the number of questioned communities for the loan. In all, we questioned over \$60 million, in addition to the \$45.6 million in the Houston area. We also identified two pilot grants to two communities totaling \$477,705. For 2004, there were no grants to communities near large cities.

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<sup>60</sup> The cities (population) and States are: Chicago (2,896,016), Illinois; Fort Wayne (205,727), Indiana; Honolulu (371,657), Hawaii; Kansas City (441,545), Missouri; Lincoln (225,581), Nebraska; Minneapolis (382,618), Minnesota; Oklahoma City (506,132), Oklahoma; Omaha (390,007), Nebraska; Pittsburgh (334,563), Pennsylvania; San Antonio (1,144,646), Texas; St. Paul (287,151), Minnesota; and Wichita (344,284), Kansas.

# Exhibit A – Summary of Monetary Results

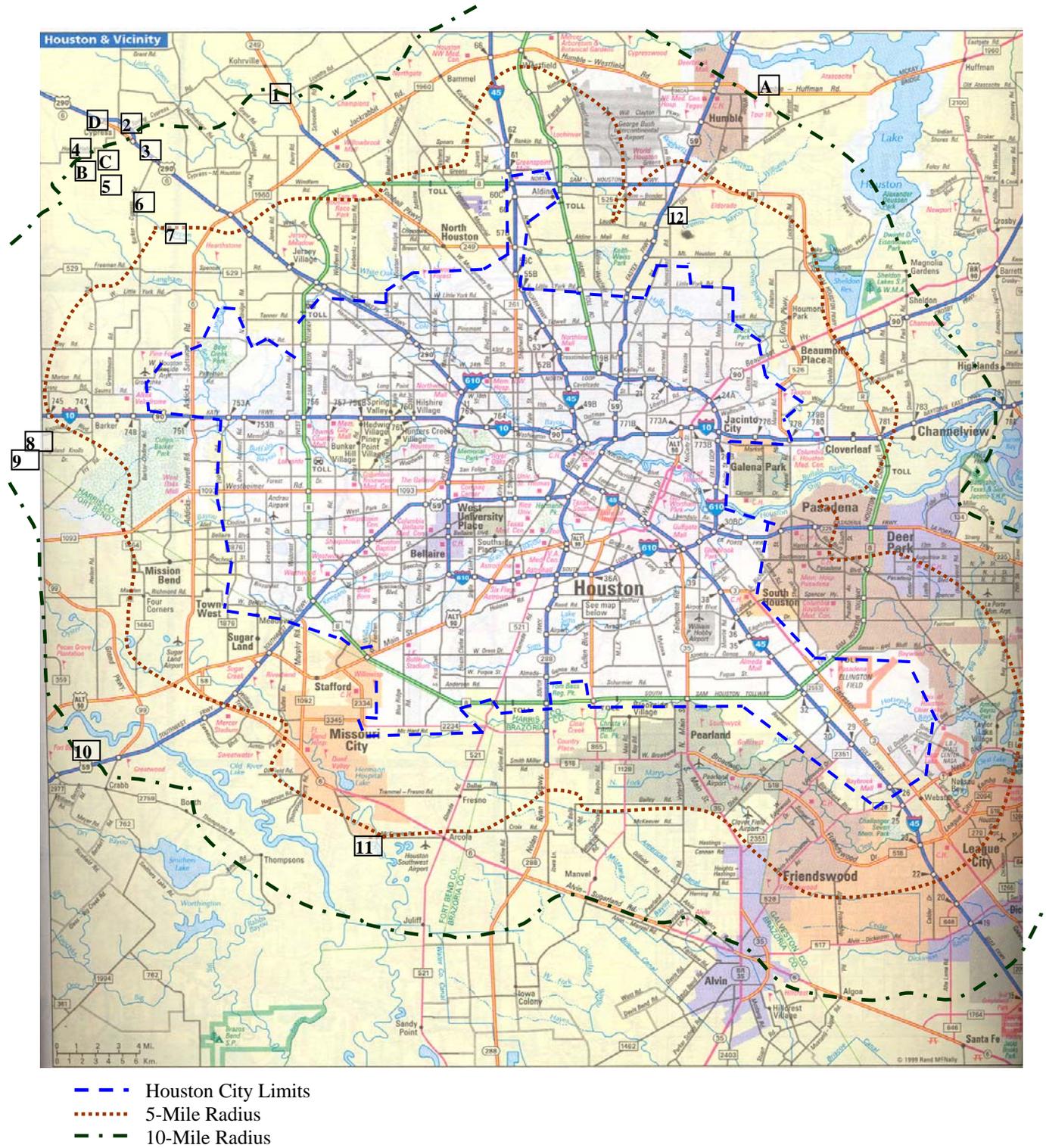
FINDING NUMBER	RECOMMENDATION NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	2	Funds Given to Communities Near Large Cities <sup>61</sup>	\$103,411,898	FTBPTBU,* Management or Operating Improvements/ Savings
3	7	Applications Not Complete <sup>62</sup>	137,434,250	FTBPTBU, Management or Operating Improvements/ Savings
3	8	Company B Deviated From Planned Use of Funds	1,936,046	Questioned Cost, Recovery Recommended
3	9	Company B Deviated From Planned Use of Funds	762,226	FTBPTBU, Deobligations
3	10	Defaulted Loans	30,377,069	Questioned Cost, Recovery Recommended
3	11	Funds Not Drawn Down	59,278,582	FTBPTBU, Deobligations
3	12	Cancelled Funds	6,792,964	FTBPTBU, Management or Operating Improvements
4	13	Duplicate Funding	383,284	FTBPTBU, Management or Operating Improvements/ Savings
<b>Total Questioned Funds</b>			<b>\$340,376,319</b>	

\* Funds To Be Put To Better Use

<sup>61</sup> The total amount for this finding is \$106,155,452; however, \$2,743,554 of this amount is included in Finding 3, Recommendation 10 – Defaulted Loans.

<sup>62</sup> The total amount for this finding is \$179,536,000; however, \$42,101,750 of this amount is included in Finding 1, Recommendation 2 – Funds Given to Communities Near Large Cities.

# Exhibit B – Houston, Texas, City Map and Vicinity



**NOTES APPLICABLE TO REPORT AND PAGE 1 OF THIS EXHIBIT:**

**Note 1.**

Subdivisions included in the \$22.9 million loan to company A and within a 10-mile radius of the Houston city limits:

- |   |  |
|---|--|
| <input type="checkbox"/> Gleannloch Farms | <input type="checkbox"/> Berkshire         |
| <input type="checkbox"/> Stablegate       | <input type="checkbox"/> Seven Meadows     |
| <input type="checkbox"/> Coles Crossing   | <input type="checkbox"/> Grayson Lakes     |
| <input type="checkbox"/> Blackhorse Ranch | <input type="checkbox"/> River Park West   |
| <input type="checkbox"/> Westgate         | <input type="checkbox"/> Sienna Plantation |
| <input type="checkbox"/> Lone Oak         | <input type="checkbox"/> Fall Creek        |

**Note 2.**

Subdivisions on the outskirts of other cities near Houston, Texas, with a population over 20,000:

Missouri City: 52,913

- Sienna Plantation

Sugarland: 63,328

- River Park West

Mission Bend: 30,831

- Seven Meadows
- Grayson Lakes

**Note 3.**

Subdivisions within the extraterritorial jurisdiction of:

*Houston, Texas (Population 1,953,631)*

- |   |  |
|---|--|
| <input type="checkbox"/> Gleannloch Farms | <input type="checkbox"/> Lone Oak      |
| <input type="checkbox"/> Stablegate       | <input type="checkbox"/> Berkshire     |
| <input type="checkbox"/> Coles Crossing   | <input type="checkbox"/> Seven Meadows |
| <input type="checkbox"/> Blackhorse Ranch | <input type="checkbox"/> Fall Creek    |
| <input type="checkbox"/> Westgate         |  |

*Missouri City, Texas (Population 52,913)*

- Sienna Plantation

**Note 4.**

Subdivisions serviced by company A, but not funded through the Broadband Pilot Loan Program:

- Summerwood
- Cypress Creek Lakes
- Cypress Creek Ranch

**Note 5.**

A proposed subdivision that was in company A's original application; however, the developer did not want to wait and contracted with another telecommunications company that did not have a Government loan.

- Cypress Mills

# Exhibit C – Homes Serviced by Company A

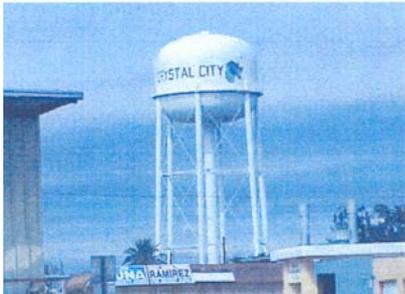


# **Exhibit D – Towers Misrepresented in Company B’s Grant Applications**

Company B’s application for Batesville, Texas:



Company B’s application for Crystal City, Texas:



Company B’s application for Pregreso, Texas:



NOTE: The pictures on the left show the same water tower, only taken at different distances. The tower is actually located in Crystal City, not in Batesville or Pregreso. The pictures on the right are duplicates of a water tower actually located in La Pryor, Texas, not in either Batesville or Crystal City, as indicated in company B’s application.



United States Department of Agriculture  
Rural Development

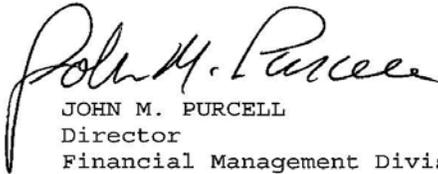
SEP 30 2005

SUBJECT: Broadband Loan and Grant Programs  
(Audit No. 09601-004-TE)

TO: Robert W. Young  
Assistant Inspector General  
for Audit  
Office of Inspector General, USDA

Attached for your review is a memorandum dated September 30, 2005, from Curtis M. Anderson, Acting Assistant Administrator, Rural Utilities Service. The memorandum is in response to your request for a response to the draft report of the subject audit.

If you have any questions or need additional information, please contact Arlene Pitter of my staff at (202) 692-0083.

  
JOHN M. PURCELL  
Director  
Financial Management Division

Attachment

1400 Independence Ave. SW - Washington, DC 20250-0700  
Web: <http://www.rurdev.usda.gov>

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**United States Department of Agriculture  
Rural Development**

September 30, 2005

TO: John M. Purcell  
Director  
Financial Management Division

FROM: CURTIS M. ANDERSON   
Acting Administrator  
Rural Utilities Service

SUBJECT: Audit Report 09601-4-TE – Broadband Grant and Loan Programs

Attached is the response to the Office of Inspector General draft Audit Report entitled, "Rural Utilities Service Broadband Grant and Loan Programs," Audit Report 09601-4-TE.

Please contact Ken Ackerman of my staff if you have any questions on 720-9460.

Attachment

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**Rural Development's Telecommunications Program  
(Telecommunications Program) Response to OIG Audit Report of  
Broadband Grant and Loan Programs (09601-4-Te)**

**Finding 1 RUS Should Develop a More Precise Definition of "Rural Area"**

**Agency Response to Finding 1:**

The decision to propose legislative language is a policy decision which requires the consideration of many factors not addressed in this report. The Audit Report is correct in identifying that, to date, the Telecommunications Program has had to operate under three different statutory definitions of "Rural Areas" for the Pilot Broadband Loan Program and the Farm Bill Broadband program. In all three cases, the Telecommunications Program consulted with the Office of General Counsel before implementing regulations defining a rural area for the general public. In all cases, the Telecommunications Program and OGC believe that the statutes were interpreted correctly and that all eligible rural areas qualify for financial assistance. The statutes only defined a rural area; it did not define a suburban area. Consistent with the history of the RE Act, the 2002 Farm Bill Broadband Loan program is intended to address the high costs of serving rural areas; it was not intended to address the income level of the area to be served. Therefore, the Telecommunications Program's focus was on defining the areas that qualified for loans at the time a particular statute was in effect (i.e. Pilot Program vs. Farm Bill Program). As indicated in the Audit Report, the Telecommunications Program definition for a rural area is broad. However, it is in compliance with the statutes. If the Telecommunications Program were to implement a definition for a suburban area, then the Telecommunications Program would have had to develop its own definition and not rely on any statutes that implemented any part of the broadband programs. The Telecommunications Program does not believe that we were to develop definitions but were only to interpret the statutes as passed by Congress. In its interpretation of the statute, the Telecommunications Program did make the definition of a rural area broad in order to cover all rural areas as intended by the statutes and to leave no rural area without the potential for broadband service. This interpretation is consistent with the intent of Congress and the President's initiative to provide universal affordable access to broadband service by 2007.

As indicated by the Audit Report, in October 2000, the Telecommunications Program made a Pilot Broadband loan to Company A of almost \$22.9 million to provide broadband service to rural areas in Texas. These areas were in proximity to Houston, Texas. However, they met the definition for a rural area, and without prejudice, the Telecommunications Program approved this loan. Once the definition for a rural area was established, the Telecommunications Program consistently interpreted that definition to qualify all rural areas that were included in a loan application. The two main qualifications to be eligible for Pilot Broadband loans were that the area did not currently have broadband service and that the area in question met the definition for a rural area. This loan met both of the above qualifications.

The Audit Report states that because the above referenced loan was approved, other loans that would normally qualify were turned down for financial assistance. The Telecommunications Program processed Pilot loan applications until all funds for this program were exhausted. Although some loan applications were not funded, all applications that have been funded were eligible.

The Audit Report further states that an additional loan to Company A was approved under the 2002 Farm Bill Program. This is correct and the Company again met the qualifications of this program.

Although the Audit Report states that the Telecommunications Program definition of rural area is defined in-accurately and has shortcomings, the Telecommunications Program's only intention is to follow the statutes that the program operates under. It is not the Telecommunications Program's intent to implement requirements that are not included in the statutes.

#### **Recommendation 1**

*RUS should obtain an Office of the General Counsel (OGC) opinion concerning its ability to restrict the law's definition of an eligible rural area.*

#### **Agency Response**

In all three cases in developing the definition for a rural area as defined by the statutes in place at that time, the Telecommunications Program worked very closely in developing the definition with OGC. The Telecommunications Program had numerous discussions with OGC on the interpretation of the statutes and the results were definitions agreed to by both the Telecommunications Program and OGC. Even if OGC were to opine that the agency could restrict the definition narrower than Congress intended, it would still be a matter of policy as to what restrictions, if any, should be imposed.

#### **Recommendation 2**

*If OGC concludes that RUS may restrict the law's definition of an eligible rural area, then RUS should develop and implement a definition of an eligible rural area that includes, as part of the criteria, a community's population density and distance from metropolitan areas. If OGC concludes that RUS may not, on its own authority, restrict the definition, then, RUS should seek legislation to clarify the program's definition of an eligible rural area.*

#### **Agency Response**

Again, as stated above, it would still be a matter of policy as to what restrictions, if any, should be imposed, regardless of OGC's legal opinion. As the audit report indicates, the FY 2004 Appropriations Act lifted the restriction of the 2002 Farm Bill that precluded the

Telecommunications Program from considering areas eligible for funding that were included in any standard metropolitan statistical area (SMSA). Prior to this, the Telecommunications Program did not fund communities that this report now brings into question. It was clearly Congress' position that the definition of a rural area be as broad as possible to cover as many rural citizens as possible.

**Finding 2 RUS Needs Stronger Controls to Prioritize Communities Without Broadband Access**

**Agency Response to Finding 2:**

The Telecommunications Program's standard operating procedures for processing broadband loan applications are as follows:

1. First in – First out. All applications that are received are logged in as to the date they are received and are generally processed in that order.
2. When a broadband loan application is received, it is reviewed to determine if the application is for communities without broadband service. If all communities included in the application are determined to have no broadband access, then that application receives priority and is moved to the front of the processing list.

The Audit Report indicates that this process is adequate as long as there are ample funds available for all approved applications. As the Broadband Program currently has adequate funds to consider any application submitted, regardless of its priority status, the current procedures of prioritizing an application are acceptable. If funding levels should reach the point where funds are not adequate to fund all qualified applications, the Telecommunications Program will then evaluate all applications on a quarterly basis to determine their place in the processing schedule.

The Audit Report indicates that certain applications that were submitted in the Pilot Broadband Program were turned down for financial assistance and that the areas included in these applications were more rural than some of the applications that were approved. As indicated above, the Telecommunications Program processes applications on a first-in, first-out basis as long as the proposed service territory and the business plan meets the qualifications for the program. Although some applications that were approved were not as rural as some of the applications that did not receive financial assistance, all applications that were approved qualified for the financial assistance and were processed in the order they were received. It should be noted that there was no requirement or expectation that the most rural applications would receive priority over other qualified applications. The priority established by Congress was based on the availability of service in places of 20,000 in population or less.

For all broadband loan applications that are submitted under the 2002 Farm Bill a market survey must be completed as part of the application process. The market survey is

intended to validate the need for the proposed services, the price points that consumers are willing to pay, the competition in the area and other related topics. To validate the market survey, the Telecommunications Program conducts its own due diligence of the proposed area by reviewing related census information, conducting research using internet resources and has the local general field representative complete on site reviews of the territory in question. Although there may be other methods for validating the local markets, the methods that are currently in place use to the fullest extent possible the resources that the Telecommunications Program currently has available.

The Audit Report indicated a \$4.3 million loan that was approved was in default because of competition in the service territory. This loan was a Pilot Broadband loan and at the time the loan was approved, it was validated that there was no broadband service in the proposed territory. This was a basic requirement to qualify for a Pilot Broadband Loan. This is a good indicator that even though there is no competition at the time a loan is approved, simply by making the loan we are identifying, for the competition, that a market for broadband services exists. Further, while reviewing this project to determine the reasons for the default, the borrower had its attorney report to the US Assistant Attorney's office that fraudulent invoices were submitted in order to draw down loan funds. Although competition in the area may have added to the reasons for this default, it is more likely that the management of this company is the main reason for the default. The Telecommunications Program attempts to monitor the projects as closely as possible but it is not always possible to maintain a level of review that will identify all faults of a project early enough to stop a project from going into default.

However, with a history of less than one-tenth of one percent defaults in the Rural Development Utilities Programs, we believe there is a good system in place to deter waste, fraud, and abuse of these programs.

### **Recommendation 3**

*Establish and implement cutoff dates to ensure that applications are evaluated for priority at least every quarter.*

### **Agency Response**

CFR 1735.15(c) currently requires that all broadband applications that have been submitted be prioritized for processing on a quarterly basis. Because of the funding levels currently available for the Broadband Program, the Telecommunications Program has been able to evaluate and prioritize as necessary each application when it is submitted. Whenever an application for an unserved area is submitted, it is processed before all other applications regardless of when the other applications were submitted.

### **Recommendation 4**

*Cease providing loans to competing broadband providers until RUS has reviewed past loans made in competitive environments. That review should determine if these loans*

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*have given funded providers an unfair financial advantage over those without RUS funds, or have otherwise adversely and materially affected the success of these loans.*

**Agency Response**

The Telecommunications Program's implementation of the Broadband Program is in accordance with the statutes that established the program. Both the 2002 Farm Bill and the President's broadband initiative identify the need for competition to increase the quality of services and reduce the cost of those services to the consumer.

**Recommendation 5**

*Based on the results of this review, RUS should determine if its practice of issuing loans to competing broadband providers should continue and take appropriate action.*

**Agency Response**

The Telecommunications Program will implement any changes to the statute that are approved by the President and Congress.

**Finding 3 RUS needs Controls Over the Approval and Servicing of Broadband Grants and Loans**

**Agency Response to Finding 3:**

The Audit Report indicated that \$236.6 million in broadband loans and grants are questionable and have broken this down into the following categories:

- 1. \$137.4 million in loans was [sic] approved even though the borrowers' applications were incomplete or inaccurate.* The Telecommunications Program disagrees with this statement. This amount represents two loan applications that the Telecommunications Program reviewed and determined to be complete. When an application is submitted, it is immediately assigned to a financial specialist and to an engineer. The specialist and the engineer complete an initial report to determine if the application is complete. The report is then presented to the Division Director. The Director then makes the decision on whether or not to consider the application complete.
- 2. \$2.7 million in grants was [sic] made to one company that then deviated from the planned use as stated in the grant agreement:* The company in question submitted invoices demonstrating that the requested funds were for approved purposes and the Telecommunications Program advanced the funds accordingly. Since then, the Telecommunications Program has conducted an accounting audit of the project and has disallowed very significant amounts of grant funds that have been used for non-approved purposes. The company is required to reimburse the government for the disallowed amounts.

3. *\$30.4 million in loans was [sic] in default due to inadequate servicing:* These loans are in default due poor management of the operations and not due to the Telecommunications Program's servicing of these loans. The Telecommunications Program monitors the loans and assists the borrowers on a multitude of levels to mitigate loan losses. The Telecommunications Program is not responsible for running the day to day operations of these companies.

4. *\$59.3 million in approved loans has never been drawn down and used:* Loans and grants are based on the estimated construction costs for the project. In many cases, actual costs are less than the estimated costs and not all funds are required. However, some of the loans and grants are still within their allowable draw down periods (construction and build out schedules range from three to five years). It is the responsibility of the applicant to requisition these funds as required for approved purposes. Once the project has been completed, any remaining funds will be rescinded.

5. *\$6.8 million in cancelled loans was [sic] not put to use in a timely fashion and was [sic] therefore unavailable for future funding:* As noted above, construction and build out schedules range from three to five years. Therefore it would be difficult in many instances to re-obligate unused funding since it must be done within the same fiscal year in which the loan was approved. When a company or the Telecommunications Program determines that loan funds are no longer required the funds are rescinded. If the rescission does occur in the same Fiscal Year as the original obligation, the funds are available to be used in that Fiscal Year. However, as stated above, in most cases, as in the case of the funds in question, a determination that the funds are not required normally occurs after the fiscal year ends and the Telecommunications Program does not have the authority to re-use the funds.

The agency also takes exception to the claim that regular compliance reviews were not performed by the Program Accounting and Regulatory Analysis (PARA) staff. For compliance review purposes, PARA had considered the Broadband Grant and Loan Programs to be one program with minor compliance differences (this is consistent with OIG's recommendation to treat these programs as one). Of the \$895 million of broadband grants and loans reviewed by the OIG, less than 5 percent of the \$895 million represented grant funds. Over 95 percent (\$854 million) represented broadband loan funds. PARA focused its compliance reviews on the broadband loan funds because this represented the vast majority of the funds. PARA wanted to focus our limited resources on where the most dollars and activity was occurring. Of the \$41 million in total broadband grants, only \$15.9 million has been advanced as of September 2005. Of the \$15.9 million, only \$946,000 was advanced in 2003.

With that noted, PARA did provide coverage of the grant program. Compliance reviews were conducted for 10 grants. PARA also held meetings with another grant recipient of five grants to make sure it fully understood the accounting, record keeping, financing, and auditing requirements of each grant. PARA's staff sent letters to all broadband grant

and loan recipients reminding each recipient of their accounting, record keeping, and audit responsibilities.

Concerning the completed compliance reviews on the seven Company B projects, PARA found \$900,000 in unsupported labor, overhead, and other costs along with prohibited profit margins.

PARA has been proactive in the broadband area. As early as 2002, PARA established a team of field accountants to perform broadband pilot compliance reviews and develop guidance in the form of a staff instruction, audit guide, and training for the other members of the staff. Compliance reviews for 20 broadband loan recipients were performed. This information was provided to OIG for this audit. PARA believes that substantial coverage for the Broadband Program has been provided and the agency is committed to continue to provide compliance review coverage for the loan and grant programs.

#### **Recommendation 6**

*Develop and implement written guidance for the Community Connect Grant Program including the following:*

- *application review and rating;*
- *training for reviewers;*
- *GFR requirements for project visits;*
- *monitoring project activity and completion (including compliance reviews);*
- *suspension or termination in accordance with regulations.*

#### **Agency Response**

Although the Telecommunications Program has implemented a number of the oversight items listed in the Audit Report (i.e. worksheets for reviewing and scoring a grant application have been developed, training is provided to the reviewers each year at the start of the review process, advance of grant funds are suspended when improprieties are identified, etc.), the Audit Report is correct in its findings that the oversight procedures have not been documented in the form of staff instructions. The Telecommunications Program is committed to the development and implementation of written guidance for the Community Connect Grant Program.

The Telecommunications Program will complete the following tasks by March 30, 2006.

- ✓ Develop staff instruction for reviewing and scoring grant application.
- ✓ Develop staff instruction transmitting and clearing grant documents.
- ✓ Develop staff instruction for advance of grant funds.

- ✓ Develop staff instruction for GFR oversight of grants.
- ✓ Develop staff instruction for servicing of grants.
- ✓ Develop staff instruction for rescission and reobligation of grants.

#### **Recommendation 7**

*Develop and implement written guidance for the Broadband Loan Program including the following:*

- *applications to be review and approved;*
- *GFRs to perform periodic reviews to ensure the proper use of funds and the viability of the projects;*
- *independent annual audit reports to be obtained and reviewed;*
- *quarterly financial reports to be obtained and reviewed;*
- *recommendations from GFR reports and compliance reviews to be analyzed and acted upon;*
- *applications and supporting documentation to be complete before the applicant is approved*

#### **Agency Response**

The Telecommunications Program has recognized the need to develop and implement written guidance for the Broadband Loan Program and has started the process of formalizing the procedures that are currently in use.

To date the Telecommunications Program has completed the following the staff instructions:

- ✓ Initial log in procedures when an application is received.
- ✓ Procedures for the initial financial review of an application.
- ✓ Procedures for the initial engineering review of an application.

In addition, the Telecommunications Program is in the final stages of completing the development of a loan feasibility model and the corresponding instructions for using this model. The projected completion date for full implementation of this model is October 30, 2005.

It should also be noted that the Telecommunications Program is in the process of developing a database to monitor the performance of all companies that are issued a loan. The database will track actual quarterly financial statistics against projected financial statements and will monitor the ongoing health of the operation. As part of this effort, a system is being developed that will allow each borrower to electronically submitted the

required quarterly financial reports. This project is scheduled for completion by January 30, 2006.

The Telecommunications Program is committed to completing the development and implementation of written guidance for the Broadband Loan Program. The Telecommunications Program will complete the following tasks by March 30, 2006.

- ✓ Staff instruction for the detailed financial review of an application.
- ✓ Staff instruction for the detailed engineering review of an application.
- ✓ Staff instruction for assembling the loan packet that will be presented to the credit committees for loan approval.
- ✓ Staff instruction for preparing and clearing the legal loan documents.
- ✓ Staff instruction for GFR oversight of the broadband loans.
- ✓ Staff instruction for servicing of the broadband loans.
- ✓ Staff instruction for rescinding and re-obligating loans.

**Recommendation 8**

*Recover advanced grant funds of \$1,936,064 from Company B.*

**Agency Response**

The Telecommunications Program has completed an accounting audit of Company B and is in the process of recovering all funds that were not accounted for properly.

**Recommendation 9**

*Deobligate the remaining grant funds of \$762,226 from Company B.*

**Agency Response**

The Telecommunications Program has suspended advances of all remaining grant funds for Company B. The Telecommunications Program is currently reviewing this situation and will take all appropriate action.

**Recommendation 10**

*Recover the \$30,377,069 for the six defaulted pilot loans.*

**Agency Response**

All of these loans have been transferred from the Broadband Division to the Policy Analysis and Risk Management Division (PARM). PARM is responsible for working with borrowers that are in default and recovering the outstanding loan balances. PARM is currently working with each of the six borrowers in question.

**Recommendation 11**

*Review all loans and grants that have not drawn down funds and determine whether proposed projects are still viable. If the projects are not viable, deobligate the funds.*

**Agency Response**

For the Pilot Broadband Loans, the Telecommunications Program is in the process of completing a review of all borrowers with unadvanced funds. Once this review is completed, the Telecommunications Program will make a determination if the funds are still required. Any funds that are not required will be deobligated.

For the Farm Bill Broadband Loans, all loans have an initial five year period to draw down funds. All of these loans are still within this period. When one of these loans reaches the end of the five year period, a financial analysis will be completed if funds remain unadvanced to determine if they are still required and can be supported by the operation.

For the Community Connect Broadband grants, all grants have a three year draw down period. The Telecommunications Program will initiate a review of all grants that have exceeded the timeframe to draw down funds. All funds that are not required to complete the projects or cannot be supported by operations will be deobligated.

**Recommendation 12**

*Establish and implement procedures to ensure cancellation and reobligation of unused grant and loan funds within the time periods specified by Congress.*

**Agency Response**

The Telecommunications Program currently has procedures in place to cancel and reobligate grant and loan funds. Written procedures will be developed as part of the action items included in the Agency's Response for Recommendations 6 and 7.

**Finding 4 RUS Needs to Unify Its Administration of Broadband Grants and Loans**

**Recommendation 13**

*Align both the Broadband Loan Program and the Broadband Grant Program under the Broadband Division to promote accuracy in eligibility determinations when processing broadband loan and grant applications.*

**Agency Response**

Currently the Advanced Services Division (ASD) of the Telecommunications Program is responsible for completing the initial review and award of broadband grants. In addition to the broadband grants, ASD is also responsible for reviewing and awarding a number of other grant programs for which the Telecommunications Program is responsible. The Telecommunications Program believes that the expertise that this division has developed in reviewing and awarding grants is essential to ensuring that all grants are awarded fairly and will continue to use ASD to review and award the broadband grants.

Once ASD has awarded the broadband grants, the grants are turned over to the Northern and Southern Divisions of the Telecommunications Program for servicing. Starting with the award of the broadband grants for Fiscal Year 2005, the responsibility for servicing these grants will be transferred to the Broadband Division. The Northern and Southern Divisions will complete the servicing of the prior grants.

**Recommendation 14**

*Develop and implement an integrated management information system that will track all loan and grant information from the date the application is submitted through servicing and project completion. The system also should include (a) All pilot loan and grant information, (b) identification of specific communities or locations for each loan or grant, and (c) dates and results of servicing activities.*

**Agency Response**

The Telecommunications Program currently has an Access data base that tracks all 2002 Farm Bill broadband loans from the time the application is received until the application is deemed ineligible for funding or until funds are made available for advance. This database is being upgraded to an SQL database and will be brought on-line shortly.

In addition to the SQL database for applications, the Telecommunications Program is currently in the process of completing a database for the purpose of loan portfolio management of the Farm Bill loans. This database will be linked to the broadband application database.

The Telecommunications Program agrees with the Audit Report findings concerning the expansion of these databases. The Telecommunications Program will start the process of expanding these databases to include all relevant information for the pilot broadband loans and the broadband grants. This effort will include incorporation of the Audit Reports recommendations.

